

104

U.S.-JAPAN RELATIONS AND AMERICAN INTERESTS IN ASIA

Y 4. IN 8/16: R 27/3

U.S.-Japan Relations and American I...

HEARINGS

BEFORE THE

SUBCOMMITTEES ON

INTERNATIONAL ECONOMIC POLICY AND TRADE

AND

ASIA AND THE PACIFIC

OF THE

COMMITTEE ON

INTERNATIONAL RELATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

OCTOBER 25 AND 30, 1995

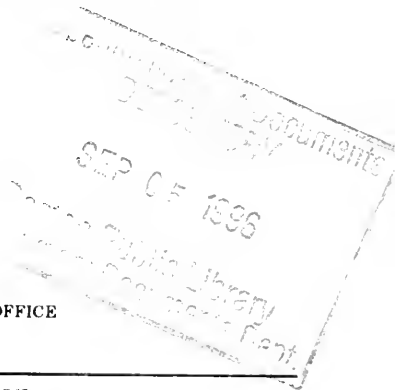
Printed for the use of the Committee on International Relations



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1996

25-481 CC

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-052909-3



104

U.S.-JAPAN RELATIONS AND AMERICAN INTERESTS IN ASIA

Y 4. IN 8/16:R 27/3

U.S.-Japan Relations and American I...

HEARINGS

BEFORE THE
SUBCOMMITTEES ON
INTERNATIONAL ECONOMIC POLICY AND TRADE
AND
ASIA AND THE PACIFIC
OF THE
COMMITTEE ON
INTERNATIONAL RELATIONS
HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

OCTOBER 25 AND 30, 1995

Printed for the use of the Committee on International Relations



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1996

25-481 CC

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-052909-3

SEP 05 1996
U.S. GOVERNMENT PRINTING OFFICE
Library

COMMITTEE ON INTERNATIONAL RELATIONS

BENJAMIN A. GILMAN, New York, *Chairman*

WILLIAM F. GOODLING, Pennsylvania
JAMES A. LEACH, Iowa
TOBY ROTH, Wisconsin
HENRY J. HYDE, Illinois
DOUG BEREUTER, Nebraska
CHRISTOPHER H. SMITH, New Jersey
DAN BURTON, Indiana
JAN MEYERS, Kansas
ELTON GALLEGLY, California
ILEANA ROS-LEHTINEN, Florida
CASS BALLENGER, North Carolina
DANA ROHRABACHER, California
DONALD A. MANZULLO, Illinois
EDWARD R. ROYCE, California
PETER T. KING, New York
JAY KIM, California
SAM BROWNBACK, Kansas
DAVID FUNDERBURK, North Carolina
STEVEN J. CHABOT, Ohio
MARSHALL "MARK" SANFORD, South
Carolina
MATT SALMON, Arizona
AMO HOUGHTON, New York

LEE H. HAMILTON, Indiana
SAM GEJDENSON, Connecticut
TOM LANTOS, California
ROBERT G. TORRICELLI, New Jersey
HOWARD L. BERMAN, California
GARY L. ACKERMAN, New York
HARRY JOHNSTON, Florida
ELIOT L. ENGEL, New York
ENI F.H. FALEOMAVEAGA, American
Samoa
MATTHEW G. MARTINEZ, California
DONALD M. PAYNE, New Jersey
ROBERT E. ANDREWS, New Jersey
ROBERT MENENDEZ, New Jersey
SHERROD BROWN, Ohio
CYNTHIA A. MCKINNEY, Georgia
ALCEE L. HASTINGS, Florida
ALBERT RUSSELL WYNN, Maryland
MICHAEL R. McNULTY, New York
JAMES P. MORAN, Virginia
VICTOR O. FRAZER, Virgin Islands (Ind.)

RICHARD J. GARON, *Chief of Staff*

MICHAEL H. VAN DUSEN, *Democratic Chief of Staff*

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE

TOBY ROTH, Wisconsin, *Chairman*

JAN MEYERS, Kansas

DONALD A. MANZULLO, Illinois

SAM BROWNBAC, Kansas

STEVEN J. CHABOT, Ohio

DANA ROHRABACHER, California

DOUG BEREUTER, Nebraska

CASS BALLENGER, North Carolina

SAM GEJDENSON, Connecticut

MATTHEW G. MARTINEZ, California

MICHAEL R. McNULTY, New York

ROBERT G. TORRICELLI, New Jersey

HARRY JOHNSTON, Florida

ELIOT L. ENGEL, New York

EDMUND B. RICE, *Subcommittee Staff Director*

JOHN SCHEIBEL, *Democratic Professional Staff Member*

CHRISTOPHER HANKIN, *Professional Staff Member*

ALEXANDER Q. SCHMITZ, *Staff Associate*

SUBCOMMITTEE ON ASIA AND THE PACIFIC

DOUG BEREUTER, Nebraska, *Chairman*

EDWARD R. ROYCE, California

DANA ROHRABACHER, California

JAMES A. LEACH, Iowa

JAY KIM, California

MARSHALL "MARK" SANFORD, South

Carolina

DAN BURTON, Indiana

DONALD A. MANZULLO, Illinois

HOWARD L. BERMAN, California

ENI F.H. FALEOMAVAEGA, American

Samoa

SHERROD BROWN, Ohio

ROBERT E. ANDREWS, New Jersey

SAM GEJDENSON, Connecticut

GARY L. ACKERMAN, New York

MICHAEL P. ENNIS, *Subcommittee Staff Director*

RICHARD KESSLER, *Democratic Professional Staff Member*

DAN MARTZ, *Professional Staff Member*

JON J. PETERSON, *Staff Associate*

CONTENTS

PART I—U.S.-JAPAN RELATIONS AND AMERICAN INTERESTS IN ASIA: STRIKING A NEW BALANCE

WEDNESDAY, OCTOBER 25, 1995

WITNESSES

	Page
The Honorable Winston Lord, Assistant Secretary of State for East Asian and Pacific Affairs, Department of State	4
The Honorable Joseph S. Nye, Jr., Assistant Secretary of Defense for International Security Affairs, U.S. Department of Defense	8
The Honorable Richard L. Armitage, President, Armitage Associates	20
Dr. James E. Auer, Director, Center for U.S.-Japan Studies and Cooperation, Vanderbilt University	22
Dr. Kenneth B. Pyle, President, National Bureau of Asian Research	25

APPENDIX

Prepared statements and biographical sketches:

Hon. Howard L. Berman, a Representative in Congress from the State of California	73
Hon. Winston Lord	74
Hon. Joseph S. Nye, Jr.	95
Hon. Richard L. Armitage	103
Dr. James E. Auer	107
Dr. Kenneth B. Pyle	112

Article ("The Context of APEC: U.S.-Japan Relations") submitted for the record by Dr. Kenneth B. Pyle	118
Statement submitted for the record in lieu of appearance by Dr. Kent E. Calder, Director, Program on U.S.-Japan Relations, Princeton University	137

PART II—JAPAN'S UNCERTAIN POLITICS AND ECONOMY

MONDAY, OCTOBER 30, 1995

WITNESSES

Dr. Robert Alan Feldman, Managing Director, Salomon Brothers Asia, Ltd., Tokyo, Japan	40
Dr. Leonard Schoppa, Assistant Professor, Department of Government and Foreign Affairs, University of Virginia	44
Dr. Merit E. Janow, Professor—International Trade, School of International and Public Affairs, Columbia University	48
Dr. William R. Farrell, Advanced Research Fellow, Program on U.S.-Japan Relations, Harvard University	52

APPENDIX

Prepared statements and biographical sketches:

Dr. Robert Alan Feldman	153
Dr. Leonard Schoppa	163
Dr. Merit E. Janow	172
Dr. William R. Farrell	188

U.S.-JAPAN RELATIONS AND AMERICAN INTERESTS IN ASIA: STRIKING A NEW BALANCE—PART I

WEDNESDAY, OCTOBER 25, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
SUBCOMMITTEE ON ASIA AND THE PACIFIC,
Washington, DC.

The subcommittee met, pursuant to call, at 2 p.m. in room 2172, Rayburn House Office Building, Hon. Doug Bereuter (chairman of the subcommittee) presiding.

Mr. BEREUTER. The subcommittee hearing will come to order. Good afternoon, ladies and gentlemen. Today's hearing is intended to examine the overall U.S.-Japan relationship against a backdrop of a changing post-cold war Asia-Pacific region. On October 30, we will hold a second more narrowly focused hearing that will examine recent political and financial instability in Japan and the implications for U.S. interest.

Our objective today is to elicit testimony in the current climate of partnership and competition the respective roles of the United States and Japan in the Asia-Pacific region. I am especially interested in the extent to which Japan continues to share the U.S. perspective on a variety of important Asia-Pacific issues. I am interested in where we should strike the balance in our bilateral ties, both among competing American policy objectives and between our relations with Japan and other regional states.

Regrettably, this hearing is even more timely than we would have wished due to the uproar in Japan over the alleged rape of a 12-year-old girl by three U.S. servicemen in Okinawa. We would all agree that this is a deeply shocking and troubling incident in its own right, but the public reaction in Okinawa and Japan raises new questions about the political basis on which the U.S. forward-based strategy rests.

I appreciate very much the effort that all of our witnesses have made to participate in this hearing today, since the hearings originally had been scheduled for October 16th, the day of the march on Washington.

Our former distinguished ambassador to Tokyo, Mike Mansfield, was famous for repeating frequently that the U.S.-Japan relationship was our single most important bilateral relationship bar none. I for one continue to regard our relationship with Japan as extremely critical to the American national interest. Although the threats to U.S. security and other interests in Asia may be less

starkly apparent than during the cold war era, they continue to be real ones nevertheless.

Japan remains our most logical security partner in the region and contributes more than any other ally to the support of U.S. forward-deployed forces. Notwithstanding our complaints about Japanese trade barriers, Japan is still our single largest export market in Asia by a wide margin. Our exports to Japan totaled \$53.5 billion in 1994, more than twice that of any single European country. They were exceeded only by exports to Canada and Mexico. Japan continues to broadly share U.S. values and goals for the functioning of the international system. This said, a number of developments in recent years have proved troubling and raise doubts about where our relations may be headed.

Fifty years after the end of the Second World War, we can congratulate ourselves on the durability of our alliance. Nevertheless, we cannot take it for granted. The cold war has ended and some of the sense of mutual dependency may have gone with it. We, on our part, may feel freer to discuss and engage in trade negotiations, even protracted and heated ones, with less concern about negative impact on our political and security interests.

Japan likewise has shown more inclination to resist U.S. market-opening pressures. One contributing factor may be that, for both countries, trade with the rest of Asia in combination recently has become greater than the volume of our trade with each other.

I congratulate Assistant Secretary Nye for the articulate reiteration of the American commitment to the alliance and the forward deployment of American forces in Asia. I strongly support this important deployment and said so very directly at our first subcommittee meeting this year.

Nonetheless, many of our constituents are asking whether our security role in Asia, including our deployments in Japan, serve Japanese interests more than our own. I certainly do not believe that is the case for reasons I have already noted, but in the eyes of many Americans, our security commitment to Japan needs a more persuasive revalidation than has yet been offered. Because of the Okinawa incident, Japanese political leaders have a similar task to mobilize public opinion in support of the alliance.

During the late 1980's, in the full flush of Japan's burgeoning trade surpluses, Tokyo appeared eager to play a larger global, political, and economic role as a partner of the United States. During the Persian Gulf War, however, Japan contributed \$13 billion to the allied cause but otherwise proved a reluctant partner. Japan's participation in U.S.-led efforts to combat North Korea's nuclear threat and deter war on the Korean peninsula remains a key element of our post-cold war cooperation. Frankly, however, questions do remain about the extent of Japan's commitment to our common objectives, especially if this should involve a showdown with Pyongyang.

Although some significant strides have been made in defense burden sharing and in passing of the landmark peace cooperation law in 1993, Japan's overall international role seems limited by weak political leadership. As I said, at the end of the month, we will have a hearing that focuses more directly on recent political and financial instability in Japan.

But in a broader sense, Japan still seems unduly reluctant, in this member's opinion, to play an international role commensurate with its economic importance. Instead it still seems to prefer to lead from behind and to pursue the narrower goals of its powerful bureaucratic ministries.

In this respect, I, like many other Americans who follow these matters, will be watching closely to see how Japan handles its responsibilities as host of this year's APEC ministerial meeting and leaders summit. It remains to be seen whether Japan shares American perspectives about the need to adopt a concrete plan of action for APEC, including, I emphasize, the APEC commitment to push free trade in agriculture.

Or, on the other hand, will Japan align itself with several other Asian countries that oppose the free trade objectives adopted at last year's meeting in Bogor, Indonesia? Will Japan propose an agenda that moves the ball forward? Or will it punt, leaving important issues to be addressed next year in Bangkok? Thus far, reports do not make us optimistic.

I would mention that Mr. Berman, the ranking minority member and gentleman from California and I, as well as 19 other members, are today sending a letter to Secretary Christopher and Ambassador Micky Kantor expressing our concerns. We voice our support for a strong effort on their part to ensure that the commitments made in Bogor are in fact implemented and that there is no back sliding in that respect. This will be delivered to these distinguished members of the Administration this afternoon.

Also on the economic side, Japan has turned in a disappointing performance in terms of its global responsibilities. Four years of recession in Japan have created significant distortions in the global economy. Until very recently, Japan's exploding trade surpluses with the United States and the world have been based more on depressed import demand than on rapid export growth.

Although U.S. exports to Japan grew by more than 11 percent in 1994, they only grew by an average of 7.5 percent during the previous 5 years. The inability of Japan's financial managers to get the economy moving probably has contributed more recently to the growth of the U.S./Japan trade deficit than has Japan's diverse and damagingly effective trade barriers.

With regard to bilateral trade negotiations under the economic framework talks, Japan has clearly become more assertive about saying no to the United States. We now have the specter of the newly elected President of the Liberal Democratic Party, having gained that office in part by his toughness in trade negotiations with the United States. That fact alone seems to reflect a new mood in Japan and the cumulative effect of rising dislike for Americans among opinion makers and a significant segment of the Japanese public.

These remarks are not intended to represent a bill of particulars against Japan. On the contrary, these developments need to be seen as troubling elements of what on the whole is a remarkably successful relationship. I look forward to beginning a full discussion of these developments and factors this afternoon.

Before I introduce our distinguished witnesses on the first panel, I would like now to turn to my distinguished colleague, the gentleman from California, Mr. Berman, for his remarks.

Mr. BERMAN. Well, thank you, Mr. Chairman. My prepared remarks cover some of the very same issues, some of the issues that you raised and I think just in order to save some time, we have five witnesses, and have enough time for questioning I will just ask that that statement be included in the record and add this time to my question time later.

Mr. BEREUTER. Thank you very much, Mr. Berman. And I would say, I think—while I am knocking on wood here—that we are in for a rare luxury of having no votes the rest of the afternoon. So we should be able to have a very good opportunity for testimony and for questions. Given the importance of the issues that I have outlined—an assessment that, in whole or in part, Mr. Berman apparently shares, we are fortunate to have two very strong panels to address them.

The first panel consists of the Assistant Secretary of State, Winston Lord, and the Assistant Secretary of Defense, Joseph S. Nye. Both have appeared at previous hearings of this subcommittee and need no recitation of their distinguished backgrounds and numerous accomplishments.

But I do want to thank both of you distinguished gentlemen for the excellent testimony you have offered in the past before this subcommittee and the full committee, and for the cooperative way that you have extended your assistance to this member and to all the members of the subcommittee. I do thank you for an entirely positive relationship; cooperative examples like yourself would be hard to replicate.

I would like now, before I introduce the second panel, just to hear from our first two distinguished witnesses. I would call upon Secretary Lord unless you have a different order in mind. Mr. Lord, I am going to suggest the usual 5 or 10 minutes. You can summarize or use your statement as you wish. I think we should have plenty of time for you to cover your remarks in one fashion or another. Please proceed as you see fit.

STATEMENT OF THE HONORABLE WINSTON LORD, ASSISTANT SECRETARY OF STATE FOR EAST ASIAN AND PACIFIC AFFAIRS, U.S. DEPARTMENT OF STATE

Mr. LORD. Thank you, Mr. Chairman. I will submit the full remarks for the record and give you some excerpts. Let me begin by reciprocating the very generous comments you make. I am sure I would speak for Joe Nye as well as to say that we have found very refreshing and stimulating and helpful with a series of hearings that this committee is conducting on East Asian policy and the productive manner in which you conduct these hearings. I think it is contributing to the national debate and our national interest. And it is a pleasure to be back here again.

I may also note that Joe Nye and I will be traveling with Secretary Perry to Japan as well as South Korea next week.

The U.S.-Japan relationship is always an important topic. I think it is particularly timely for the reasons suggested in your opening statement and what I take to be some of Congressman Berman's

statements as well. Our relations with Japan, as you said, have been called our most important bilateral relationship and this has not changed. And let me say that many of your themes in your opening remarks, both the analysis and the implied policy prescriptions, the Administration would fully endorse.

I do believe the United States and Japan's interests are predominantly congruent, as you said remarkably successful, a partnership despite some problems and I believe they will continue to be so in the years to come. We share an interest in global peace and security. Our diplomatic coordination is close and fruitful. Our agenda and global issues are broad and growing. The U.S.-Japan alliance based on the treaty is essential to the defense of both countries, a central element of our policy of forward deployment and contributes directly to security and prosperity throughout the region.

It is absolutely crucial to our presence and to our continuing influence in the Western Pacific and Asia and I might add it is warmly welcomed by the countries of the region.

Moreover, the United States and Japan as enormous economic actors share a responsibility for the well being of the world economy and I mentioned how we were in frequent contact on global economic management and various international institutions.

Naturally, we have some differences with Japan. This is to be expected in a relationship as large and as active as ours and they particularly arise in the trade area, of course.

We have had success on some of the framework for economic partnership and there and elsewhere under the Uruguay round we have resolved about or made progress on 20 sectorial and structural trade issues. There have also been some steps taken by the Japanese to stimulate their economy and American economic front, but this is unfinished business and both countries must continue to address and resolve issues of this sort constructively as they arise so that they do not hamper not only the rich commerce but the overall ties between the United States and Japan.

And finally, we have common values as well as interests, a shared commitment to freedom, democracy, promotion of human rights and the rule of law, both in our own societies and in relation to other countries. And it is the vision of the world based on these principles that lies at the center of the excellent relations between our two nations.

My statement then goes on to describe the domestic political scene in Japan as well as recent economic trends. And for the sake of time and the fact that you will be focusing on this in particular in a couple of days, I will not comment on that in my verbal remarks except to end up by saying that the political realignment, of course, has affected the decisionmaking process in Japan, including on issues of interest to the United States. But we have no reason to expect change in Japan's basic policy of strong support for our alliance and U.S.-Japan cooperation in general.

Again, I cite some of the economic trends and end up by saying that although Japan faces challenges in deregulating and stimulating its economy, its economic fundamentals remain strong and I explained that Japan's long-term economic prospects remain good. It is and will remain a central economic partner for the United States and we are hopeful that Japan will enjoy more rapid growth in

1996 and that with that growth U.S. exports and goods and services to Japan will rise.

In short, Japan is in a period of political change and it is grappling with economic problems that are not trivial. However, we expect U.S.-Japan ties to remain strong and the Japanese continue to support close relations and cooperation between the United States and Japan. But this reservoir of good will is not something which we can take for granted as you yourself suggested. It needs to be nurtured lest it dwindle.

I then address the security situation and again the Assistant Secretary and I will go into this in considerable detail. So I will be very brief. But I wish to emphasize again that this alliance based on our treaty of cooperation and security is the key to continuing U.S. influence throughout East Asia. It also directly contributes to the security and economic well being of the American people. The presence of our 47,000 military personnel in Japan combined with the home port of Seventh Fleet ships personnel allow us to contribute to the maintenance of stability in the region, full store regional arms competition, including nuclear arms and exercise influence over the course of events. It is a platform for not only deployment but activities elsewhere in the region. And it underpins a strong diplomatic partnership allowing us both to better manage our relations with other Asian countries and indeed the world.

I then describe, and I am sure Mr. Nye will go into this, an intensive security dialog we have been conducting with Japan for the last year and a half. We thought it particularly appropriate in the post-cold war environment, the 50th anniversary of World War II, to reexamine and reaffirm our alliance and Joe Nye and I and our deputies have had a series of meetings.

This culminated in what we called a two-plus-two meeting in late September in New York where for the first time ever the Secretaries of State and Defense and their counterparts met, not only to push forward our cooperation and our examination and affirmation of our alliance, but they also welcome the signing of a special measures agreement which will help contribute to the costs of our forces there and this now will be about \$5 billion annually or 70 percent of the cost to us—more provided than by any other ally and in fact more than the amount provided by all other allies combined. It is less expensive for us to maintain forces in Japan than here at home.

So we think there is a very good case to be made, both to the Japanese and American people on the continuing importance of this alliance and we expect to do that as one of the highlights of the President's trip to Japan in November, not only for APEC but his State visit afterwards to Tokyo and we are working on a declaration of our shared security interest for that trip.

I then discuss the heinous crime, the alleged rape on Okinawa by three U.S. servicemen. As you know, we have moved quickly to show our sensitivity to this, both as a horrible incident in itself, but also its impact on our alliance and I am sure you want to get into that in your questions. But our top officials from the President on down have expressed regret and shock.

And I am happy to report that today after some fast and mutually sensitive work the last couple of weeks that just today Ambas-

sador Mondale, U.S. Forces Japan Commander Lt. General Meyers and Japanese Foreign Minister Okono agreed on improvements in the implementation of criminal jurisdiction procedures under the bilateral Status of Forces Agreement. Under this decision the United States has agreed to give sympathetic consideration to Japanese request for transfer of custody of criminal suspects prior to indictment. It used to be *after* indictment in specific cases of murder or rape.

I then go on to describe our very close diplomatic cooperation with Japan around the world. And again I will save time, but whether it is Korea, Cambodia, Asian regional security forum and other regional security dialogs, regional economic issues, we work very closely in Asia. We work very closely around the world where Japan has stepped up its peacekeeping and global responsibilities. Again, a theme you touched on in your opening remarks. And I think we should see how far they have come the last couple of years in meeting responsibilities in deploying forces or observers for the first time in places like Cambodia and Mozambique, helping out Rwanda refugees and shortly by sending peacekeepers to the Golan Heights. Prime Minister Murayama recently visited the Middle East and underscored whether it will be helpful there. We work closely on the Korean nuclear issue together. Japan will make a major financial contribution to replace North Korea's nuclear program with less proliferation. They are engaging us in a serious dialog about contributing to reconstruction of Bosnia. And we work very closely on a common agenda, new issues like the environment, population, women and development. Many others are very important, very successful, somewhat inherited agenda of cooperation between the two of us that not only helps our bilateral ties but global problems.

Finally, I discuss the U.S.-Japan economic relationship, point out the continuing global current surplus and large current account surplus with the United States. Japan is a very important market for us and I give the figures for that to show that it not only is important, but that our exports have been going up; including in those areas where we have reached agreement in recent years.

We think it is in Japan's interest to open up its market, in the interest of its consumers as well as in the interest of the global economy and our bilateral relations. And we will continue to urge Japan to correct its persistent surplus, open up its market for competition and remove impediments to businesses. This is not only in our interest. It is in Japan's interest as well as the global economy as I have said.

I then mention specifically the agreements that we have reached under the framework as well as under the Uruguay round and it is very important now that in addition to dealing with other problems that remain before us like deregulation and competition policy and further macro economic steps that we vigorously pursue the faithful implementation of the various agreements that we reached. And this would be a very high priority.

I mentioned APEC and I am sure I speak for the Secretary who will be getting your letter that he will welcome such a letter on the importance of carrying forward the commitments of Seattle and specifically Bogor in the Osaka meeting. And I mention here that

any step back from a comprehensive approach to trade liberalization in the region would be a major setback to APEC and very frankly right now Japan and Korea and some others are fudging on that principle. So we are going to work very hard to make sure that we continue to make progress. We think that is in Japan's interest as well.

Finally, Mr. Chairman, in conclusion, our approach from the very beginning of this Administration was to look at this rich and productive partnership, note that our major problems lay in the trade area and rather than let them fester and perhaps infect public support on both sides of the Pacific over time for the relationship, to address these issues head on and try to make progress even as we insulate it from possible frictions in the economic area, our security ties, our common agenda, our diplomatic cooperation and the other positive aspects of our partnership.

We work very hard on this, I think, despite the sensitivities of the 50th anniversary of the end of World War II, a socialist government in Japan, trade negotiations which are very tough and the end of the cold war. We have done a remarkably good job of protecting our security and other interests. However recent events as you cite, make clear we can hardly be complacent and therefore we have got to continually nurture our ties and seek to mitigate problems.

Finally, I note that the President will be traveling to Japan in a few weeks, not only for the APEC meeting, but for a State visit. And we are determined, working very closely now with our Japanese allies to highlight the very positive aspects of our partnership that I have suggested. So this visit to Japan by the President therefore comes at a very important juncture. Together our two countries have traveled an enormous distance in the past half century. Building on that solid record and recognizing the global implications of our bilateral ties, we will strive to boast one of the world's most productive partnerships. Thank you, Mr. Chairman.

[The prepared statement of Mr. Lord appears in the appendix.]

Mr. BEREUTER. Thank you very much, Secretary Lord, for your very comprehensive and informative testimony. I should mention that Secretary Nye will be leaving government service, at least for a while again. I believe at the end of this year he will become the Dean of the John F. Kennedy School of Government at Harvard University, an institution and a college and school for which I have special affection. And while we may not hear from you again before this subcommittee in your capacity as Assistant Secretary, we look forward to having the benefit of your wisdom and in your future role as well.

So welcome to you. Please summarize, read, and proceed as you wish. We look forward to your testimony.

**STATEMENT OF HON. JOSEPH S. NYE, ASSISTANT SECRETARY
OF DEFENSE FOR INTERNATIONAL SECURITY AFFAIRS, U.S.
DEPARTMENT OF DEFENSE**

Dr. NYE. Thank you very much, Mr. Chairman. I would like to underscore what Secretary Lord said in thanking you personally and this committee for the leadership it has taken on this range

of issues. I think this has been a good case of bipartisan and executive legislative cooperation.

I also want to underscore what Winston said about the importance of the agreement that was reached today on finding procedures for the implementation of the Status of Forces Agreement in cases of criminal jurisdiction. I think this may help to set behind us the immediate problems. And when Secretary Perry is in Tokyo next week, he will be looking with his counterparts at ways to reduce the burdens placed upon the people of Okinawa by the U.S. presence there. And that would include action such as adjustment of our procedures or redistribution of troops throughout Japan, but not reduction in our overall forces because we believe that the overall force structure is essential to the stability of East Asia.

This is something which goes back a full year or so to November, 1994 when the Departments of Defense and the State began an initiative to reaffirm our security relationship with Japan. We no longer regarded this as simply a cold war relationship, but in fact looked at it as a basis for stability in Asia in a post-cold war world. In January of this year when we appeared before your committee, we sketched out some of the early thoughts about this; they were in the form of the U.S. strategy toward East Asia which was then being drawn up and I am glad to be able to report now more fully on where we stand.

Basically, the U.S./Japan security relationship is fundamental to our position in East Asia. You asked for a strong rationale for the security relationship. I would say that it would start with the fact that Japan has foresworn war as a sovereign right and cast its strategic fortunes with the United States. The bilateral security relationship with Japan provides unprecedented American influence and adds fundamentally to our security.

These advantages are of vital national interest and are the foundation for our position in Asia and the Pacific. The security relationship endures because Americans and Japanese national interests overlap significantly and both countries work to preserve the profound mutual benefits. In a sense as we have seen since World War II, we are interested in having an American defense perimeter as far away from U.S. soil as possible; in this case 5,000 miles west of San Francisco.

Close security ties with Japan greatly enhance the U.S. political role in Asia. And Japan's political support on key security issues have been indispensable for preservation of peace in the area. Our commitments not only serve to protect our national interests, but serve the interests of our allies as well. In that sense the Japan government has told us explicitly that Japan is perfectly capable of rearming in a serious way and developing its own nuclear capabilities. But it has a strong preference for avoiding this option and having a self-constrained security policy.

Japan wishes to preserve the security relationship because the American security guarantees make this possible. In many ways, Japan has done a great deal to contribute to security in the region. It is a faithful member of the nuclear non-proliferation treaty, cooperating in the post cocom non-proliferation measures, and in terms of working with us on the North Korean case; as Secretary

Lord said, their financial support will be in the range of \$1 billion for the U.S.-North Korean framework agreement.

In a triangular relationship which will emerge in East Asia as China continues to grow, it is extremely important that the United States not be the odd man out among the three most powerful actors of the United States, China, and Japan. Asian and global stability depend fundamentally on the peaceful integration of China into the international community and a productive dialog with Beijing led by the United States and Japan is a vital ingredient to this process. So we believe that future stability in East Asia rests upon this close U.S.-Japan strategic relationship and is a leftover from the cold war period.

I would say that with the closure of U.S. bases in the Philippines, Japanese bases on the great circle route from the West Coast to Singapore take on increased importance for deployments in the Persian Gulf area. If the Suez Canal were not available to U.S. forces, support from Japan and U.S. bases there would be much more significant in maintaining a viable U.S. military peace time presence in Asia and the Pacific as well as the Indian Ocean and the Persian Gulf.

I should also mention that Japan is a major purchaser of U.S. military equipment and builds many systems under license; Japan also has done a great deal to expand its efforts in international peacekeeping operations, humanitarian assistance and disaster relief operations. This is a considerable change from a position of just a few years ago. In a sense in that way Japan is indeed helping us to share global burdens. So we believe that the view that Japan is a free rider is no longer the case.

What we have been doing in the dialog with Japan over the last year is focusing on the U.S. commitment and Japan's contributions and the way we together can create regional stability. Japan will take on some new missions in the area of peacekeeping operations and air defense. We both are working together to confront the immediate challenge of North Korea. We are both working together to understand how we can manage to help China successfully integrate itself into the regional security system. And while the security dialog is an ongoing effort, the initiative we have undertaken during the past year is now focused on the security declaration which Secretary Lord referred to and which will be issued by the President and Prime Minister of Tokyo at the bilateral summit.

I would also add that the single most important U.S.-Japan bilateral security meeting of this Administration took place on September 27 in New York in the two-plus-two meeting that Secretary Lord referred to where Secretaries Perry and Christopher met with Ministers Kono and Eto. This culminated the previous year's work and laid the basis for the successful summit in November.

That meeting accomplished two very significant goals. The first was having four top Cabinet officials in the Cabinet reaffirm the bilateral relationship and the centrality of the security relationship for the post-cold war period. And second, the signature of the Special Measures Agreement which meant that Japan continued to be our most generous ally in host nation support.

We also managed to have a useful discussion of the National Defense Program Outline that Japan has developed. We told the Jap-

anese Government that one measure of success of our year-long dialog would be a clear overlap in approach between the National Defense Program Outline and the Department of Defense's East Asia strategy report as published this past February.

I will skip my answers to the detailed questions that the committee posed unless they are raised here and will refrain from going through that part of my testimony in the interest of saving time. But what I would like to say is that we believe that it is important to put the recent unfortunate and deplorable case of the rape in Okinawa in the proper context.

This situation was a terrible incident, but it does not detract from the point that the U.S.-Japan security relationship remains critical to both countries for the future peace and prosperity of East Asia. I believe that it is a good point to make that the U.S.-Japan alliance is stable, that the result of this year-long dialog has been to reaffirm that and that it serves our mutual interest and is the bedrock of stability in the region.

The government of Japan unequivocally supports the continuation of the alliance and continued U.S. military access to the bases. And we believe that what we are going to see at the summit is a situation where we will have a security declaration issued by the President and Prime Minister which will reaffirm that critical importance of the alliance to both countries.

We have agreed in principle to the declaration or working now on details of the language that will establish publicly the basis for continued strong bilateral security ties. So this is an interim progress report on something which I hope we will be able to give you a final report on after November 20th, but I want to thank you for your support on it during the year while it has been going forward.

[The prepared statement of Dr. Nye appears in the appendix.]

Mr. BEREUTER. Thank you very much, Mr. Secretary, for your statement. I have read it in its entirety and we look forward to pursuing some questions with both of you gentlemen. I think I will begin with the security relationship. Secretary Nye, do you think that the end of the cold war suggests any new divisions of roles and missions between the United States and Japan's forces in the Pacific East region?

Dr. NYE. We think that there will be some additional roles that Japan will take on. For example, I mentioned in the area of peace-keeping and humanitarian operations the way that Japan has undertaken missions in Cambodia, Mozambique and Rwanda which are very different from anything they were doing just a few years ago. And to the extent to which Japanese public opinion continues to support that, we have indicated to the Japanese during this dialog that we will be supportive.

Mr. BEREUTER. Is it true that it is more likely—at least initially—that public acceptance in Japan will be greater in Southeast Asia if they are in places like Africa? Or is the Cambodia experience now an experience that has satisfied the concerns of the Japanese and other Asian countries?

Dr. NYE. Well, the next case that we are aware of where the Japanese have volunteered to be helpful is on the Golan Heights. So they are not limiting themselves just to Southeast Asia, but indeed

are seeing this as a global responsibility and I should say that we welcome that.

Mr. BEREUTER. I think he is asking the reverse question, whether it is more sensitive for them to be.

Dr. NYE. Oh, whether it is more sensitive, sorry. There are sensitivities indeed in Southeast Asia, but I think that if you look at the roles that Japan has taken on Southeast Asia, they are not military roles in the sense of the operational roles that we have, but they are military to military contacts. There are ship visits. There are a series of confidence building measures that Japan has taken on and I think that in humanitarian and disaster relief operations, there would not be a problem for Japan in Southeast Asia.

Mr. BEREUTER. I would like to pull you back to the subject of the military roles. Do you think there will be new military roles for Japan in a post-cold war era?

Dr. NYE. At this stage as you know, Mr. Chairman, the Japanese Constitution restrains Japan from acting internationally beyond 1,000 miles of its borders on international waters. In other words, Japan cannot undertake military roles in other countries. The Constitution restricts it to a self-defense role.

So I do not expect that there will be military roles in that sense, but there will be roles within the framework of the U.N. charter of the type that I mentioned.

Mr. BEREUTER. Do you think that under current interpretations of their Constitution, Japan can go a significant distance if necessary to help us with military contingencies in the Korean peninsula?

Dr. NYE. Yes, Japan is able to provide us with support for actions that we may need to take in Korea. Japan would not be able to fight alongside us in Korea because this would be outside its borders. But in terms of providing us the support as we undertake operations the answer is yes.

Mr. BEREUTER. Thank you. I will come back to you perhaps if we have time, but I would like to move to Secretary Lord now and focus on a remark I think you made. I quote, "There are a few issues on the horizon that have the potential to grow into disputes if we do not act to resolve them". Could you be more explicit about that?

Mr. LORD. Sure. I think that is in the economic section. Certainly multi-laterally there is no question that this issue of comprehensiveness is very important, but I think you are looking at the bilateral economic relationship. We still have ongoing civil aviation talks. We have a Kodak case which is very important and we do want to make progress on deregulation.

So the point I was making there is that even though we have made significant progress in 20 agreements and even though we wish to make sure that implementation is faithfully carried out, we still have an unfinished agenda in the trade area. And as we highlight the positive aspects of our relationship outside trade, including during the President's trip, we do not want to leave the impression that we do not have still a lot of work to do on the trade side, even though the public atmosphere may be somewhat calmer and we may be more in an implementation phase.

Mr. BEREUTER. So you feel that most of those issues would fall in the economic or trade area?

Mr. LORD. Well, obviously we cannot be complacent even in a security area for reasons we have all noted today and we work very hard at that. But that particular phrasing, I believe, came up in the economics section. That is what I was referring to.

Mr. BEREUTER. When the President meets in Tokyo after the Osaka summit, do you expect the agenda to include an effort to conclude additional bilateral agreements and, if so, do you want to say anything about—

Mr. LORD. You mean on the economic front?

Mr. BEREUTER. I do not know. Generally.

Mr. LORD. Yes. Well, certainly we have already. We are discussing with the Japanese on an ongoing basis now a series of outcomes for that summit. We have indicated very strongly that we plan and hope to have a security communique. We will have new initiatives we believe on the Common Agenda that I referred to in my remarks.

Mr. BEREUTER. Do you think there would be anything in the area of human rights and democratization?

Mr. LORD. Well, certainly that, as I indicated in my statement, is something we share values on, whether there will be any concrete initiative I do not know. Certainly we will stay in close touch on that. I do not know whether it lends itself to a particular initiative. But obviously in some of these areas like Cambodia or elsewhere we have worked together. This is concrete support for democracy.

Mr. BEREUTER. I understand that the Japanese have been helpful in urging the Vietnamese to cooperate in resolving MIA/POW cases. Do you anticipate that Japan could play an even larger role in raising human rights issues with Hanoi?

Mr. LORD. Well, on the MIA question they have been helpful, but that is essentially a bilateral issue between us and Hanoi and we have made good progress in that as you know, allowing the President to normalize relations. On human rights, we welcome Japan's support, not only in Vietnam but China and elsewhere, Asia and the world because we do share these same values. I will be very frank, although Japan is certainly one of our more helpful partners along with Europe and Australia and so on, no country pursues this as energetically as the United States and we would welcome even more help, frankly.

Mr. BEREUTER. Prime Minister Mahathir of Malaysia has been promoting the formation of an East Asian Economic Caucus, as you know, it has been described as an Asian caucus "without Caucasians". The United States is opposed to the idea of the EAEC and has reportedly urged Japan not to join. How do you view the support for the EAEC among Asian nations today? And in view of Japan's participating in opposition with APEC over the comprehensiveness principles, are we seeing a de facto EAEC emerging?

Mr. LORD. I would not make the connection you suggest at the end of your statement. The comprehensive issue is a matter of Japan's sensitivity to agricultural trade in particular, and Korea and China and Taiwan are the other ones that are holding out on this principle. And on that we believe that if you start excluding a sen-

sitive sector, other nations will exclude their sensitive sectors and all of APEC and the Bogor declaration could unravel. So I would not make any connection to the EAEC there.

Mr. BEREUTER. I take it you agree, though, that this is a repudiation of the Bogor agreement. That is our U.S. position, is it not?

Mr. LORD. It would be a major setback. I want to be careful about the language we use here, but this is a very important issue, not just for us but for the great majority of APEC nations who signed on to Bogor. They are as concerned as we are that the comprehensive principle be maintained. Now, it does not mean that as you carry forward trade liberalization looking toward the Bogor target dates that there cannot be some adjustments in the pace in which you move toward liberalization in certain areas and this certainly is a comparability issue as well. Namely, if a country makes sacrifices in sensitive sectors, it can expect its trading partners to make comparable efforts in their sensitive sector.

So we are still hopeful that we can work this out with Japan. I would like Japan to think that given its stake as host to APEC this year, given its stake in the global economy that it would come around and we could work out an agreement on a comprehensive principle. But we still have to do this with Korea and China and the others as well.

Now, to get back to your main question unless you want to dwell back to the EAEC part of your question. We have been very skeptical, to say the least, of any East Asian grouping that would exclude us on issues that we think we have a legitimate interest in. We have taken a somewhat different at least tonal and tactical position in the previous Administration which was very vigorous and flatly against EAEC and was somewhat confrontational about it. I mean, it had some good conceptual and political reasons for that. We have tried to see a further definition of what the Asians, particularly Malaysia, have in mind. We try to do this in a non-confrontational way and to see whether in fact there could be some kind of grouping that we could live with. We have not seen that yet. We are very skeptical. We think the focus should be on APEC which includes countries on both sides of the Pacific. We never use pressure on our allies, of course, but we have encouraged Japan and Korea and others to look closely at any such strictly Asian group working that might work against our interests as well as their own and they have been very faithful in discussing this with us.

Mr. BEREUTER. Thank you. I was wrong about our vote, as I often am in this place. But I have had my nearly 10 minutes. So I would like to turn to my colleagues. Perhaps he could have 9 or 10 minutes before we go vote. So I yield to Mr. Berman for his questions.

Mr. BERMAN. Thank you, Mr. Chairman. Secretary Nye, I join with the Chairman in wishing you well and saying that we will miss you. In fact, as a new member of this subcommittee back in January when you came to the subcommittee it was very helpful to me in getting a sense of what the discussion was and what issues were involved in terms of security arrangements and forward basing and the whole U.S.-Japan relationship.

This summer I went to Japan for a conference. Everyone there was talking about these articles in the foreign affairs magazines. I guess you wrote one and then Chalmers Johnson and E.B. Kean wrote a response. I would be interested in your response to their argument. Did you read the article that comes after your own in these things?

Dr. NYE. It is an old academic habit.

Mr. BERMAN. We frequently do not. So I do not need you to spend a lot of time. Essentially, it is a frontal assault on this defense report on East Asia, on essentially the Japanese primarily and the other countries suggesting they are taking us to the cleaners. This is ridiculous. No one has any confidence that we will really do anything even though we are claiming to be engaged and that we are losing all our leverage on critically important economic issues by virtue of the importance that we claim to put and that we put onto these questions. I would be interested in, I am trying to think of whether I should even read one paragraph to get a sense of what they are saying.

Dr. NYE. I know it well.

Mr. BERMAN. All right. I would be interested in your response to their argument.

Dr. NYE. Basically, the Johnson argument is that Japan has to become what they call a "normal country" to be able to take care of its own defense. And that unless it is in that situation of taking care of its own defense, it will not be able to have a normal or satisfactory relationship with the United States.

My own view is that that begs the question of what is normal in a world which has a non-proliferation treaty. Is it normal that countries have to develop nuclear weapons? In an East Asia where there are not a series of rich institutions such as you have in Europe after the cold war, how would Japan provide for its security and defend itself without alliances?

And if the Japanese were pressed in the direction because the Americans abandoned them following Johnson's recommendation of providing for their own defense and decided then to develop power projection capabilities and nuclear weapons, would Japan and would East Asia and would the United States be better or worse off? It seems to me quite clear that all three would be worse off.

The first thing that would happen if Japan tried to provide for this defense along the lines I described, it would stimulate an arms race in the region by China, by Korea, by Southeast Asia. And that, in turn, would make the United States worse off because to maintain a presence in the region would have to increase our armaments. In addition, it would raise the prospects of conflict in the area and make it more expensive if it occurred.

So this phrase "become a normal nation" glosses over a situation, which, in fact, I would argue is quite normal. There has been peace and prosperity in East Asia because of the American presence as a non-territorial member of the East Asian system. And as a non-threatening country, we are accepted by all and are able to provide a sense of reassurance in the area. That has allowed the East Asian economies to flourish; it has been good for them and been good for us.

So I think the prospect that Johnson does not adequately address is would we and Japan and other parts of East Asia be better off if we followed his advice. I think if we went out and asked in the East Asian capitals as well as here, the answer would be no.

Mr. BERMAN. But there is another element to his argument which is that as long as we view the issue this way on the fundamental economic and trade issues we are going to be taken to the cleaners. That our deep commitment to this integrated defense strategy, this forward presence, this collective approach toward security in Asia gives up our critical leverage so that they pay some money in host nation support while our military uses their flat display panel technology that even in the context of weapons, they are not buying off-the-shelf items from us. They are insisting on sharing the technology. There is slop over to the economic relationship.

Dr. NYE. There is a wonderful non-sequitur in that argument which is it assumes that if Japan were providing for its own defense, they would not develop their own flat panel display technology. Of course, that is silly, they would. The argument would only be true if they were giving up capabilities in the economic area because of our security interest, but there is little evidence for that.

I should point out that the time of the Halifax summit of the G-7, we were disputing with the Japanese quite rigorously about trade issues, particularly automobiles. At the same time we were carrying forward our security guarantee. They were on separate tracks and one did not interfere with the other.

So I think that Johnson and Company would have to provide evidence that we are being hurt that way. Now, there is another variant to the argument which says why do we not threaten to withdraw our security guarantee unless they give us everything we want on trade or something like that. That will work once, might even work twice. But the Japanese are very smart people and after you do that to them once or twice, they are going to say this is not worth it.

So if Johnson is making the first argument that the Japanese would not do flat panel displays, it seems to me it does not follow from the premise. If he is making the second argument, that we should use this for leverage, as I say, it will work once or twice but then essentially you are a double loser. Because no longer do you have the trade influence because that will be broken, but you will also not have your forward-based security position.

Let me point out that we are in East Asia for our interest as well as for Japan's interest. And the fact that the Japanese agreed in this two plus two meeting a month ago to provide approximately \$5 billion a year host nation support is very impressive. That is \$25 billion which ain't peanuts. I would point out that in addition to that, it leads to a result that is cheaper for us to have troops stationed in Japan than in California. That means that if you look at the questions of the American presence—

Mr. BERMAN. It is quite apparent that people here think that.

Dr. NYE. But if you look at the question since we want to have a forward presence in East Asia for a variety of our own strategic reasons, Japan is making a significant economic contribution toward that.

Mr. BEREUTER. Excuse me, gentlemen. I would like to continue this, but Mr. Berman and I need to go vote immediately. I would declare that we will be in a 15-minute recess and we can return. [Recess.]

Mr. BEREUTER. It appears that we are going to have another vote in 15 or 20 minutes. So we will try to complete our questioning of this panel and introduce the new one before we proceed. I know Mr. Berman is on his way back and will be with us shortly to continue his questions. I am pleased to recognize the gentleman from South Carolina who has joined us. I would like to pursue one question while Mr. Berman is on his way with Secretary Nye. And, Mr. Secretary, I wanted to discuss the SOFA, Status of Forces Agreement. Do you anticipate that in response to the terrible incident that took place there, there will be an emphasis on revising the Status of Forces Agreement or restructuring the military presence on Okinawa? Are we simply too early to speculate what might be the result of that incident? And, regardless of whether or not the incident had happened, was there any discussion or consideration being given to some changes in SOFA, especially related to Okinawa?

Dr. NYE. We do not regard as necessary to reopen the entire SOFA which as you know covers a vast range of subjects. The issue that had arisen was only over a particular area which was criminal jurisdiction. And we felt that on the issues of criminal jurisdiction, we were able to reach an agreement which would meet the Japanese Government's concerns.

In fact, the Japanese Status of Forces Agreement in the area of criminal jurisdiction was quite a generous one. It allowed the alleged perpetrators to be handed over at the point of indictment, whereas some of the SOFA agreements that we have with our European allies only require hand over at the time of sentencing. So it was already a more generous SOFA.

The difference was in the implementation agreements where there had developed informal implementation practices with some of our European allies which allowed them to request the hand over in particular heinous cases at an earlier stage. The language which we agreed upon with the Japanese Government after working on this very closely, basically, as Secretary Lord said, is we will give sympathetic consideration to any request made by Japan in specific cases of heinous crimes of murder or rape. And the United States will take full account of any special views in other types of cases.

So basically we feel we have reached a good agreement with them and good in terms of Japanese interest, good in terms of American interest. And we hope that it will put that dimension behind us.

There is a larger question which is the burden of the common interest that we share in having American troops forward-based in Japan which is borne by the people of Okinawa. And on that even before the terrible crime of the rape occurred, we and the Japanese Government had begun looking at ways to reduce some of the impact on Okinawa. There are some instances where we could make adjustments to forces in Okinawa, where we can make adjustments

to procedures of how the bases are run which can reduce some of the burden on the Okinawan people.

That has been underway before the crime occurred, and as I mentioned in my testimony, Secretary Perry will suggest to his counterparts in Japan next week that we establish a procedure to see whether there are other ways where we can make adjustments of redistributing forces within Japan or changing some of the procedures to reduce that burden. But we are not talking about true reductions which we think is not in the interest of the Okinawans and the Japanese or the East Asians generally.

Mr. LORD. Could I make just a couple of comments on top of that? Basically reinforce it very briefly.

Mr. BEREUTER. Yes, Mr. Secretary.

Mr. LORD. Not only do we not think there is a need to revise the SOFA, the Japanese Government does not either. This is clearly, this alliance and this treaty, and our forward presence, this is in Japan's interest as well as our own as expressed in their political support as well as in their financial support.

I also would like to say that this was a horrible incident, but the vast majority of troops in Japan conduct themselves with dignity and respect and we should not lose sight of that. Needless to say, we have to be sensitive and improve the performance. It goes without saying. But I do think the contribution our forces make there should be recalled.

We have as Joe Nye said, been working on some specific Okinawa issues going back several years. We have made considerable progress and indeed on some of these it is Japan's turn to respond to our latest suggestions.

Finally, it would be a serious mistake in our view, and I just want to underline this last point Joe and I made, whatever we do about consolidation or relocation it is a serious mistake to touch our troop levels. Nothing has underlined our engagement and given heart to our Asian friends in the Asia Pacific region and the maintenance of our force levels, which I am happy to say has broad bipartisan support in the Congress. And indeed getting back to the earlier debate on the Foreign Affairs article, it greatly serves our interest, including our economic interest, to maintain those forces. So let us separate out troop level reductions from possible consolidation and sensitivity.

Mr. BEREUTER. Thank you very much. We certainly agree with your assessment on both counts, of course, of our troops and their conduct and the performance of their duties. We do have another vote on. So I would yield 5 or 6 minutes to the gentleman from California to complete his questioning, and then we will permit this panel to go about the rest of their day. The gentleman from California.

Mr. BERMAN. Thank you, Mr. Chairman. I will try and be a little crisper in these few minutes remaining. It is just that I think that article, I think for a lot of people in this country there is some resonance in that article and I think it is very important for us to be dealing with the issues they raise so that we keep the support of the American public for positions I think all of us agree make some sense.

You talked, Secretary Lord, about the diplomatic range of issues that we are working closely with Japan on. There is one glaring exception that I am aware of and that is our policy toward Iran. Our belief that essentially Iran, its present leadership, its support for terrorism, its interest in we think in developing weapons of mass destruction, its desire to destabilize its neighbors needs to be contained and to be pressured.

Japan has given us no cooperation in that effort. They are joined by every other country in the world in giving us no cooperation in that effort. But they may be the primary partner that we should be seeking here given their extensive relationships. What do you think we should be doing about that?

Mr. LORD. First, a general point and then a specific one very briefly. Even in as productive and wide ranging a partnership as Japan, we are not going to agree on every last issue. The vast majority we are very close. Others we have nuance differences. Very few issues I can think of where we have sharp differences. Burma is an area where we do not have complete agreement to cite another one and Iran to a certain extent.

Now, I think our analysis of Iran is quite different from Japan. We are much more concerned about its activities I think than Japan is, although Japan, needless to say, is among the most sensitive to nuclear questions in the world.

Having said that, it is not fair to say we have had no cooperation. We have made this a very high priority issue at the highest levels with Japan about their aid to Iran or proposed aid to Iran and the Japanese have for some time now delayed major loans to Iran for construction of a dam at our specific request. They have not officially cut that off, but as long as it does not happen, we have to look at that as being cooperative. So it is not as if they have not taken our views into account even though I do agree with you that our analyses are somewhat different.

Mr. BERMAN. My final question. Do you sense among the Japanese people a growing questioning of that could have real implications in terms of upcoming elections and the Japanese Government, questioning the need for a continued U.S. presence in Japan as opposed to sort of in East Asia?

Mr. LORD. I think Joe Nye also will want to respond to this as well. Polls even in the wake of the horrible incident in Okinawa continue to show very heavy, I think over 70 percent, support in Japan for the U.S. security alliance and its importance. I think the Japanese people broadly recognize that this is in their own national interest as well as in the interest of stability and prosperity in the Asia Pacific region.

But as with any polls with public opinion, it depends how you ask the question. If they move onto saying do we need all those bases in order to do this, then the figures start dropping. So certainly we are not going to be complacent about this. We are going to continue to work at it as we have the past year and as the President will.

But I think there still remains very broad support for the alliance and I think if you ask the questions in the right way and if you have dialog with most of the Japanese people, they will under-

stand the need to implement that alliance through a presence of our forces and our bases. Maybe Dr. Nye would like to comment.

Dr. NYE. Just a quick footnote. I think what Secretary Lord said about how the question is asked makes a big difference. You can find some polls which suggest skepticism by not majorities but considerable numbers, but they are usually questions about security arrangements which could cover all sorts of things like noise abatement procedures at bases.

But when you ask questions about is the security alliance important and you get people instead of thinking about the annoyance of the noise yesterday but about do you want to live alone in East Asia 10 years from now, then I think you get very strong support for the U.S.-Japan security relationship.

Mr. BERMAN. Secretary Lord, Secretary Nye, thank you very much for your exceptional testimony and for your responses to our questions. We very much appreciate your time. The committee will stand in recess for what I predict once more will be our last vote. And we will call the second panel immediately upon our return.

[Recess.]

Mr. BEREUTER. The hearing will resume. As I mentioned, we have a second very strong panel of private witnesses. This is a distinguished group composed of Ambassador Richard L. Armitage, President of Armitage Associates and formerly Assistant Secretary of Defense for International Security Affairs, among other high level appointments. I have always been impressed with Ambassador Armitage's candor, his intellect and his energetic approach to every issue.

And Professor James E. Auer, Director of the Center for U.S.-Japan Studies and Cooperation at Vanderbilt University and formerly the Special Assistant for Japan in the Office of the Secretary of Defense. And Dr. Kenneth Pyle, Professor of Asian Studies at the Jackson School of the University of Washington and President of the Asian Bureau of Asian Research.

We will also include in the printed record of this hearing a statement of another invited witness, Professor Kent Calder of Princeton University who would have been here on October 16th, but had a prior commitment for today. As a matter of fact, as a member of the Banking Committee, I can say that he came to testify before us on Japanese banking issues last Monday.

Gentlemen, thank you very much for coming and participating in this hearing. I will say first of all that your entire statements will be made a part of the record. You may read or summarize as you see fit. We will allow you a generous amount of time to make your presentation and we will begin with Ambassador Armitage. Welcome.

STATEMENT OF HON. RICHARD L. ARMITAGE, PRESIDENT, ARMITAGE ASSOCIATES

Mr. ARMITAGE. Thank you very much, sir, Mr. Chairman, gentlemen. You have got a lot on your plate this afternoon, votes and Rotunda ceremonies and whatnot. So press right on. I want to salute the committee for taking the time to look at Asia. All eyes these days seem to be on Bosnia, for instance, for understandable reasons. But the fact of the matter is if you look at something that

will affect our lives and children and grandchildren's lives, it is Asia and how it develops in this next generation.

So I think hats off to members of this committee and to you, Mr. Chairman. We look for justifications. I think you mentioned in your opening statement that you needed a little better rationale for undergirding our presence in East Asia and particularly that in Japan. And perhaps I can say the things that members of the Administration find it difficult to say.

In addition to everything Mr. Lord and Joe Nye said, I think I would like to add the following. In just a few years in my view, the peninsula of Korea is going to be united. How it happens, I do not know. My crystal ball is as muddy as yours.

But whether it is from confrontation or collapse or osmosis, it is going to be a unified peninsula in the not too distant future, and that is going to present us all with enormous challenges. There are the challenges of war in the first instance and the challenge of coping in the other instances with a very heavily armed peninsula and historic neuralgia area. And you cannot cope if you are not in the neighborhood. It seems to me that is a pretty good underpinning for our presence in East Asia.

But while Korea and the developments on the peninsula might be our most important pressing problem, the most important in size and intensity for us is the development of China as China takes its rightful place on the world stage. And over the next generation, three to four hundred million more miles join the lines in China as their economy grows apace of 9 and 10 percent growth rates and as she rearms. The way China approaches the future is going to be very heavily influenced, as far as I am concerned, on whether or not we have made a decision that the Pacific is going to remain an area of influence to the United States.

We will not have influence in Asia unless we have military presence there. I said in my statement that it is not very pleasant, I think, for most Americans when they come to the realization that although they would like to be wanted and valued in East Asia for their great democracy and democratic traditions and multi-racial societies, multi-religious society, and our catalytic capability as an economy, the truth is that we are a factor in Asia because of military presence; and I think any Asian nation at least in private conversations would say the same thing.

The developments in the Taiwan straits have left me with an uneasy feeling. We have an overwhelming interest in a peaceful resolution of the question of Taiwan, a question to be resolved between the Taiwanese and the People's Republic of China. But as I say, we cannot be involved in peaceful resolutions if we are not physically in the neighborhood. I might say that the same is true of Hong Kong, and what happens in 1997 would be a very good sign post for the future of Taiwan. And again, I think it is likely that there will be a benign transition in 1997 if the United States has made it very clear that we are intent on staying in East Asia.

Finally, I noticed that the Administration has generally hit on the figure of 100,000 servicemen in Asia and I think that is a fine number. I have no quarrel with it. But I think it is bad business to pin or put a certain number up on the wall. Technological developments might allow us to reduce that over time, et cetera. And I

think it is bad business to put a number on the wall as a sign of our affection. A much greater sign of our affection, as far as I am concerned, would be the quality of U.S. leadership in the Pacific. And that is the thing that we really ought to hang our hat on.

And finally, I would like to join my colleagues, Mr. Lord and Dr. Nye, in commenting on this terrible incident in Okinawa. I think as a father, as a citizen of the United States, I certainly deplore, I think all of us deplore in the greatest possible way this heinous crime and we ought to take every instance to make that quite clear.

But I think at the same time I find myself in the very difficult position of actually supporting the Administration across the board on the question of the resolution of the Okinawa issue. They have got very heavy lifting in front of them; and how we resolve this issue protecting everyone's equities including the people of Okinawa is going to take a lot of wisdom, a lot of courage and I think a lot of intellectual elbow grease. So I think we all need to get behind them on that issue and support them. Thank you, very much.

[The prepared statement of Mr. Armitage appears in the appendix.]

Mr. BEREUTER. Thank you very much, Mr. Armitage. Ambassador, we appreciate your comments. Now I would like to call upon Professor James E. Auer of the Vanderbilt Institute for Public Policy Studies of Vanderbilt University. Welcome. Please proceed as you wish.

STATEMENT OF DR. JAMES E. AUER, DIRECTOR, CENTER FOR U.S.-JAPAN STUDIES AND COOPERATION, VANDERBILT UNIVERSITY

Dr. AUER. Mr. Chairman, my written statement will take less than 10 minutes. So with your permission I will just read it.

I am honored to be asked to present my views to the subcommittee on the subject of U.S.-Japan relations and American interests in Asia striking a new balance. I believe it is an extremely important subject and, as Ambassador Armitage said, it is encouraging to know of the subcommittee's interest in it.

Last week I attended a meeting here in Washington, DC during which a senior Defense Department official in a previous Administration expressed his view that the United States and Japan do not really have an "alliance" even though there is a "security relationship". He said that true allies will "take off their jackets and fight for each other" and, although this may constitute the U.S.-Japan relationship in the future, it is not a past and current situation.

Although I understand that view and respect the gentleman who expressed it, I disagree. Had deterrence failed in the 1980's and had the United States and the Soviet Union clashed in the Northwest Pacific, it is my judgment that Japan would have engaged its significant anti-submarine and air defense assets to augment U.S. forces. I believe that Japan would have taken off its coat and fought alongside the United States because there was a high degree of trust between President Reagan and Prime Minister Nakasone, and because, if Japan had refused to fight under those conditions, I do not think the United States would have allowed the continuation of the U.S.-Japan Security Treaty. Thus, in such a sit-

uation I believe Japan would have supported the United States because to do so was in Japan's national interest.

U.S.-Japan defense relations have been more positive than trade frictions obviously. And in the 1980's, Japan possessed a high technology, air defense and anti-submarine network which complemented U.S. power and contributed meaningfully to negate any political benefits of Soviet military power in Pacific Asia. In the Persian Gulf War, however, Japan decided, unwisely in my opinion, not to contribute even token military forces to the U.S.-led coalition, leading some to believe as my interlocutor last week suggested, that Japan is not a real U.S. ally.

Despite the fact that the United States and Japan, as the world's two leading economic powers, do have increasingly similar national interests in preserving both regional and global stability, Japan hesitated to send forces to the Persian Gulf because of the beliefs of some government leaders and of some elements in the public that Japan is legally prevented by its Constitution from sending military forces outside of Japan's local area. During the cold war, Japan was located in close proximity to the central egress point of virtually all Soviet Pacific oriented military power. Many, although not all, of the same people who believe Japan cannot operate abroad in areas such as the Persian Gulf believe that Japan can engage in military operations around Japan even if Japanese territory is not actually invaded.

Those in Japan who believe Japan cannot engage in collective self-defense and deploy forces outside of Japan's local area are not exclusively members of the Social Democratic Party of Japan (SDPJ—formerly Japan Socialist Party) and the Communist Party. Some members of the long-ruling Liberal Democratic Party (LDP), which lost exclusive control of the Japanese Government in 1993 and which presently governs in coalition with the SDPJ, also feel Japan cannot engage in such actions. Unfortunately, the relationship of trust between the top leadership of the United States and Japan is not as strong today as it was in the 1980's. If Japan firmly determines that it cannot participate in any scenario other than one in Japan's immediate vicinity, then I would agree that Japan cannot be a real ally of the United States now that the cold war is over and the biggest threats to the United States and Japan may not just happen to be located in Japan's immediate proximity.

But others in the LDP as well as many in the major opposition party, the "Shinshinto" or New Frontier Party, believe that while Japan is legally prohibited from conducting offensive operations, Japan has the legal right to engage in collective self-defense and send Japanese military forces abroad as a complement to U.S. forces as Japan did when it sent four mine sweepers and two support ships to the Persian Gulf following Desert Storm. While these Japanese believe that Japan can thus "take off its coat" and be a worthy ally of the United States in a variety of post-cold war scenarios within the present Constitution, some of them would like to remove the present ambiguity and clear up Japan's right to do so by amending Article 9 of the Constitution.

As does Ambassador Armitage, for whom I was honored to work during the Reagan administration and with whom I am pleased to testify today, I strongly support the rationale and goals of the Pen-

tagon's "United States Security Strategy for East Asia and Pacific Region" signed by Secretary Perry and prepared under the auspices of Assistant Secretary Joseph Nye. I know that Secretary Nye has initiated in-depth dialog with Japanese officials about the importance of the U.S.-Japan security relationship and I hope, owing at least partially to that effort, Japan will reach a consensus that it does indeed have the right to engage in collective self-defense operations that will allow Japan, legally, by political decision, within the present Constitution or via a revised and clarified Article 9, to join the United States as a real ally in the post-cold war world when it is in Japan's national interest to do so.

As Assistant Secretary Nye's report points out, the immediate security problem in Asia is the clear and present danger of North Korea. And while cautioning that the United States should "engage" rather than try to "contain" China, the report realistically notes it is in the U.S.'s interest to prevent the emergence of an Asian hegemon. I believe that Japan shares the same concerns as enumerated by Secretary Nye and supports the same or similar goals. And most important, regardless of what happens in North Korea and in China in the future, if the economically and militarily strong United States and Japan remain closely linked in a true alliance, neither North Korea nor China will be able to threaten Pacific stability in the economic center of the world.

Four of the five ships I served on as a naval officer from 1963 to 1983 were homeported in Japan. Whereas the Philippine bases I frequently operated from were extremely convenient for supporting Southeast Asia operations, the bases in Japan are much more essential to viable U.S., Western Pacific and Indian Ocean operations. During my naval career I operated frequently with Japan's highly professional Maritime Self-Defense Force. And in the unstable post-cold war world we live in today, I believe the joint U.S.-Japanese naval exercises to which other Asian navies, including those of China and Russia, might be invited to participate have never been more important as a symbol of American and Japanese determination to prevent any disruption to stability in the Spratly Islands, in the Taiwan or Malacca Straits or in other strategic locations in the Pacific Basin.

Before closing, I want to add a word about the recent incident in Okinawa Prefecture, Japan in which a 12 year old girl was allegedly raped by three U.S. servicemen. I was in Japan from September 24th to October 6th this year and this incident was at or near the top of the news every day I was there. Many, if not all, Japanese in Okinawa and elsewhere are outraged by this action. And some are saying that if U.S. servicepersons are endangering the well being of Japanese youth, what is the purpose of the alliance, especially after the cold war? I could only tell the Japanese with whom I met that all the Americans I know are also outraged by this incident. As the father of an 11-year-old daughter, I do not know how I could personally cope with such a tragedy. But while Japanese and Americans are outraged at what allegedly took place, every Japanese I met said that this aberration should not call into question the U.S.-Japan alliance which is fundamental to Japan's and the Asia Pacific's well being.

In conclusion, Mr. Chairman, I believe as I think Ambassador Armitage and Assistant Secretary Nye do, that maintaining a solid U.S.-Japan alliance is a wise bipartisan U.S. policy which greatly contributes to peace and stability in the Asia Pacific region during and after the cold war, particularly if trust can be strengthened at the Head of State level, and if Japan makes clear that it does have the right to participate in collective self-defense, I believe that Japan has the wherewithal to continue to be a worthy U.S. ally without acquiring offensive military capability or without becoming a military super power.

Japan is the second largest economic power in the world. Its population is larger than Russia's and is virtually 100 percent literate. Japan still has the particularly capable anti-submarine, mine-sweeping and air defense forces which helped deter the Soviets in the 1980's. Together the United States and Japan which constitute only about 7 percent of the world's population represent a robust 40 percent of global GNP. A solid U.S.-Japan stability force is, in my opinion, a wise insurance policy against instability and is, therefore, the best way to create an international environment in the Asia Pacific in which there is no way to settle disputes except through peaceful means. Thank you, Mr. Chairman.

[The prepared statement of Dr. Auer appears in the appendix.]

Mr. BEREUTER. Thank you very much, Dr. Auer. The subcommittee is joined by one of its most active and knowledgeable members, Mr. Faleomavaega. Thank you very much for coming. We look forward to the gentleman from American Samoa's participation. Now I would like to call upon the final witness of this second panel, Dr. Kenneth B. Pyle, President of the National Bureau of Asian Research, Professor of Asian Studies, University of Washington. Dr. Pyle, welcome. Proceed as you wish.

STATEMENT OF DR. KENNETH B. PYLE, PRESIDENT, NATIONAL BUREAU OF ASIAN RESEARCH

Mr. PYLE. Thank you very much, Mr. Chairman. Thank you for inviting me to testify today. In addition to my statement, for the record I would like to submit a copy of an article on U.S.-Japan relations in connection with the APEC conference which will be published shortly before that conference.

[The article appears in the appendix.]

Mr. BEREUTER. Without objection, thank you very much.

Mr. PYLE. I would like to briefly summarize my statement. In reviewing the present state of our relations with Japan, I believe there are five factors that should be borne in mind. My first point is a point drawn from history.

After every great war in the last two centuries, the victorious nations have always taken the lead in shaping the new institutions of principles that will govern international relations in the post war era. Specifically following World War I and World War II, it was we Americans who created the new institutions and rules to establish an order in the Pacific.

I believe we have not yet done that in the post-cold war era. There are certainly reasons for this lack of initiative. The sudden unexpected end of the cold war. The absence of an immediate threat to peace. Our present preoccupation with domestic problems.

And especially in Asia there are several cold war issues that are still with us. The division of Korea, the Taiwan problem and the Kurile Islands dispute. Nonetheless, it is our place to provide the leadership for a new order. No other country can lead in the region.

My second point is that the U.S.-Japan relationship will be the most critical aspect of the future Asia Pacific order because it links the dominant economic power of Japan with the dominant military power of the United States. But in the post-cold war era, this relationship I believe is still beset by contradictions and anomalies. It will be difficult to sustain indefinitely in a present asymmetrical form.

A half century after the end of World War II, we continue to maintain 46,000 troops in Japan and to provide a unilateral security guarantee for the Japanese state at a time when we are running a \$50 to \$60 billion trade deficit with Japan. And if we include the exports from Japanese firms in Southeast Asia to the United States, the deficit is well over \$80 billion.

Why is the world's largest debtor nation providing the security for the world's largest creditor nation when many Americans regard Japan's economic power as a greater threat than any other country's?

The short answer is that the United States and many other Asia Pacific countries do not trust Japan to rearm responsibly. Of course, Japanese bases do serve the American national interest as well. And since Japan is paying 70 to 75 percent of the bill, it is argued that is a good bargain.

In the long run though, playing a role akin to mercenaries does not suit either the national character of the Americans nor does this dependency role square with Japan's national traditions.

My third point is that the new realities in the region also make a reappraisal of our relations with Japan essential. What are the important new features of post-cold war Asia? When World War II ended and the cold war began, only one Asian State had industrialized. That was Japan and its industry was destroyed.

Today we have a large number of industrial and increasingly prosperous states which have a vital stake in the new order and which should share in the burden of its maintenance.

There is an enormously enhanced economic interdependence in the region and that ensures that the economic component of national security calculations will be magnified.

The age of nationalism has dawned in Asia. These former colonies are now self confident, self assertive independent states, often critical of the west.

And then a major new development in the past 10 years is Japan's massive economic expansion into Asia. This Japanese presence in Asia is not necessarily congruent with American economic interests. Japan has adopted what I would call a regional industrial policy. It is quite similar to the industrial policy that Japan used to develop so successfully its internal economy and which has made it so difficult for us to crack the Japanese market. It involves close business government cooperation and the coordinated use of private investment, official aid and trade in order to help Japanese multinationals build vertically integrated production networks throughout Asia.

I would add that despite the recession in Japan and the banking crisis, the trends of dramatic Japanese investment in Asia continue. This move to offshore production, of course, is the result of the strong yen and allows Japan to export to the U.S. market without further inflating Japan's own trade deficit with the United States.

My fourth point is that maintenance of the security alliance with the United States is critical to Japan's economic strategy. It is vital to its foreign policy. And it is essential to its domestic political system. Therefore, I think we should expect a greater degree of reciprocity and burden sharing.

Across the board virtually all sectors of the Japanese political spectrum support the treaty, the mutual security treaty. After opposing it for more than 40 years throughout the cold war, the Socialist Party this year came around to support it.

The treaty is important and essential to the Japanese because it reassures the rest of Asia that Japan will not be a military threat. And therefore, it provides a cover or a guarantee of the Japanese economic strategy in Asia. It also domestically avoids the disruption and divisiveness in politics that would inevitably occur if Japan were forced to revise its Constitution and establish an independent military. This would entail a far-reaching crisis and far-reaching changes in the Japanese political system.

Finally, many Japanese leaders with whom I have talked in recent months are increasingly concerned about China and its uncertain political military strategic intentions in the future. Japan increasingly looks to the Americans to assume responsibility for containing Chinese military power.

In summary, one of Japan's leading strategists put it, the American alliance is the bedrock upon which the fate of our nation, that is Japan, rests.

My fifth point is that because in the post-cold war era security is no longer simply strategic and territorial, but is now also much more economic, we must look at the whole U.S.-Japan relationship. Many believe that we should keep the security aspects of the alliance on separate tracks as Secretary Nye said; separate from economic issues that are the source of so much friction. We should not, they say, link economics and security because trade friction might jeopardize our security structure. But I believe that we can no longer separate out economics and security in Asia. They are indivisible.

What then are our options regarding the alliance? Where do we strike a balance? Broadly speaking, I think there are three options before us. One is we can continue the alliance in its present form indefinitely as the new defense department report on security strategy for the region envisions, maintaining our present bases and troop levels. Japan will be kept at global civilian power.

This, however, will leave the United States overwhelmingly responsible for maintaining security for an economically thriving and prosperous regional economy dominated by Japan. It will require us to seek continually increased host nation support from Japan which already pays 70 to 75 percent of the cost of keeping U.S. bases and forces in Japan.

The United States will more and more fill a role akin to mercenaries. This peculiar arrangement is necessary because Japan is not trusted to have its own defense. Although the Japanese are pleased to have the bases serve their national interest at this stage, the day could come when an increasingly assertive Japan will reject the anomaly of financing foreign bases that are there in part to contain Japan.

A second broad option would be for the United States to draw back from its close ties with Japan and adopt a classic balance of power approach to East Asian security. Former Secretary of State Kissinger has said that, and I quote, "The relations of the principle Asian nations to each other bear most of the attributes of the European balance of power system of the 19th century. The wild card is the attitude of the United States which has the capacity to function in much the same way that Great Britain did in maintaining the European balance of power until the two World Wars of the 20th century."

The trouble, the drawback, of this kind of approach, a balance of power approach is that while it would help resolve some of the contradictions and anomalies of our present policies, it would compel Japan to embark on a rapid independent rearmament. The prospect of growing Chinese strategic influence, a potentially unified Korea, these and other worries would likely stir Japan to exercise the nuclear option.

And so a third broad option is the establishment of a new U.S.-Japan equilibrium, a comprehensive revision of the alliance based on clearly defined new purposes, a more equal and reciprocal alliance with a rationale attuned to the new realities of post-cold war Asia.

I think this is important, we must recognize that for the first time in its history Japan has become a status quo country with as great a stake in the stability of the international system as any country. It should, therefore, carry a much greater burden of preserving stability in the international system.

A revised alliance should clearly link economic and security considerations and include a commitment to achieving the following goals. First, there must be a harmonization of economic institutions so that the rules of the game in trade and competition are acceptable to both countries.

Second, there must be closer cooperation on official aid projects, official development assistance.

Third, a reciprocal alliance should entail sharing of dual use technology.

Fourth, a revitalized alliance must be predicated on Japan's playing an enhanced role in collective security.

Eventually such a revised U.S.-Japan alliance might serve as the core of an organization of Pacific nations, an integrated security community formed at U.S. initiative which would be less exclusively dependent on U.S. resources. In this way, the goal of preventing an independent Japanese military would be achieved through positive measures rather than through the present relationship which is increasingly out of step with the new conditions in the region. By articulating a coherent new vision and mission for the alliance, we can ensure the support that will be required both

at home and in the region to sustain and strengthen it in the post-cold war era. Thank you, Mr. Chairman.

[The prepared statement of Dr. Pyle appears in the appendix.]

Mr. BEREUTER. Thank you very much, Dr. Pyle. Dr. Pyle, would you come down in support of option three if I pushed you?

Mr. PYLE. Yes, I think I gave that away.

Mr. BEREUTER. The other two distinguished panelists here have heard the three broad options that Dr. Pyle is suggesting here. Your statements seem to indicate that both of you favor option No. 1. I am sure you might elaborate and make some distinctions there, but it was basically to continue the alliance in its present form. If I misread you, you will correct me, I am sure. But what do you think about the third broad option that Dr. Pyle identifies which is, in short, a revised U.S.-Japan alliance serving as the core of an organization of Pacific nations—an integrated security community, one that would not tempt the Japanese to become an independent nuclear power?

Mr. PYLE. Mr. Chairman, before the other two go at me, I would like to say that I think it is impossible to change this relationship overnight. This is not something that we would change in the next several years. But I think it is important that we have a vision of a different kind of future. I think we should look at this present arrangement as a transition and we should have a vision of some different kind of future. Otherwise, 10, 20 years from now we will still have this large number of troops in Japan and we will have an Asia economically dominated more and more by Japan.

Mr. BEREUTER. Well, I would ask two panelists on the panel with that stipulation of intent transition, what would be your reactions? Mr. Armitage.

Mr. ARMITAGE. Yes, sir. Thank you. My reaction, Mr. Chairman, is as I heard the statement, it was a very articulate exposition of a theoretical academic approach to the problem of policymaking. You know, it seems to me that a lot of people think that there should be sort of a neat platonic package into which everything must neatly fit.

But it has been my experience as a practical purveyor, if you will, of policy that the actual making of foreign policy is about as neat and as elegant as the making of sausage. And it does not lend itself to grandiose visions into which everything neatly fits. You have a general idea of where you want to go which is affected by day-to-day course changes. You tend to manage relationships that way.

Mr. BEREUTER. Dr. Auer, do you have any reaction you would like to share?

Dr. AUER. Yes, sir. As far as item four in Dr. Pyle's option three, Japan playing an enhanced role in collective security, I think my statement was very ringing and a specific endorsement. I also support in principle his items 1, 2, and 3. And I think the United States and Japanese Governments would both say they were trying to harmonize economic institutions, more closely cooperate on ODA and share dual-use technology. Those are easy things to say, difficult things to do. I certainly support them in principle, but I think all of us, including Dr. Pyle, do agree that the alliance itself is extraordinarily important and necessary.

Mr. BEREUTER. Thank you. Assuming that Japan has resolved to reduce its political and constitutional obstacles to collective security, what would be in your judgment some of the adjustments that might be made in the role of Japan with respect to the United States in security arrangements in the Pacific rim? And I will ask you to build upon that, too, bearing in mind that there seems to be less risk of Russian aggression at this time in that region.

Mr. ARMITAGE. Well, I will be glad to try and answer. I am one of those that thinks the jury is still out on the Russian question. And as I indicated, whether the changes are cosmic or cosmetic, I guess we will come to an understanding of the Russian Federation in the next few years as we witness their actions in what they describe as the near abroad; the signs at least in Georgia, Armenia, and Azerbaijan are not good in that regard.

I would like to be involved in trying to encourage a lot more cooperation on collective security. It would certainly be an ASW reconnaissance long-range patrol air defense and things of that nature, but I would be putting a lot of emphasis in practical cooperation with the United States in PKO type activities. And I would be trying to encourage the Japanese to agree with me in that regard.

Mr. BEREUTER. PKO activities within the region?

Mr. ARMITAGE. Not necessarily. I am delighted with their activities in Africa, their willingness in the Golan and I would like to stretch that envelope to the maximum extent possible, Mr. Chairman.

Mr. BEREUTER. Dr. Pyle, Dr. Auer.

Dr. AUER. Mr. Chairman, I think the meat of the Japanese self-defense capability today, which I had an opportunity to observe up close as a naval officer stationed in Japan several times, is 60 destroyers in their Navy. They are the only Navy in the world other than the United States that has the AEGIS weapons system; also the Japanese have 200 F-15 aircraft, 100 still capable F-4's and 100 P3C anti-submarine aircraft.

As I mentioned, during the cold war, if Japan happened to be located right next to Vladivostok, those forces were exactly in the right place. If I am a Pentagon planner and can consider that these forces might be available to me if the United States and Japan act together in Southeast Asia or in another critical location, these are very, very useful. However, if in fact the Japanese say hard and fast that if there is any scenario other than one immediately around Japan, these forces absolutely cannot be used, then these forces are almost completely meaningless to me.

So I think Japan's clarifying its legal ability to use forces defensively, in coordination with the United States or in U.N. peacekeeping operations, would strengthen deterrence and help share the defense burden much more, as I think we all believe Japan ought to do as a more normal nation.

Mr. BEREUTER. Dr. Pyle.

Dr. PYLE. I would put my emphasis right now on getting the Japanese to play a much more forthright role in collective security. They passed the PKO bill in 1992, but froze the most important part of it which would have allowed them to participate in a much more wholesome way in peacekeeping. What they do now is basically humanitarian work, engineering, building bridges, that kind

of thing. In a new security crisis such as the Gulf crisis, I think the pressure is going to be on the Japanese once again to show that they can contribute personnel in a more forthright way.

Mr. BEREUTER. I wonder if any of you would have any suggestions about how the SOFA arrangements could be altered to make the very significant American presence on Okinawa more acceptable. Dr. Auer.

Dr. AUER. The SOFA, Mr. Chairman, I think is not the critical document. The critical document is the treaty relationship between two countries and particularly the trust on which that is based.

Mr. BEREUTER. Is it primarily related to the judicial system or is it much broader than that?

Dr. AUER. The SOFA, I believe, is really the implementing details of how a treaty relationship is administered. Criminal jurisdiction is a very small item in a SOFA. There was a gentleman that used to work for Ambassador Armitage by the name of Phil Barringer who wrote most of these SOFA's. And I cannot tell you how many paragraphs there are, but I would suspect there might be 100, and criminal jurisdiction is one. A SOFA handles a case such as, what happens if a soldier, a U.S. serviceman stationed in the overseas country happens to violate a local regulation.

As I think Dr. Nye or Mr. Lord pointed out, on that issue of criminal jurisdiction, of the 45 SOFA's the United States has, the one with Japan is the most generous one. The man is turned over at indictment—

Mr. BEREUTER. Generous from the point of view of the Japanese?

Dr. AUER. The Japanese. They get the man sooner. Now, there is a provision in the U.S.-German SOFA that the Germans, who do not ordinarily get the prisoner until after he is sentenced and his appeal has run, can ask for an early turnover in a special case. And the United States has pledged to give something like positive consideration. To my knowledge, that provision in the German-U.S. SOFA has never been exercised. And from what I understood Mr. Lord and Dr. Nye to say, apparently this is the type of similar arrangement that Ambassador Mondale and the Japanese have worked out. Overall, when I was in Japan, I thought the SOFA and the treaty worked very well and I do not think any major change is necessary.

Mr. BEREUTER. Gentlemen, I would think that the fact that 11 percent or so of the total island of Okinawa is devoted to American military use is a bigger day-to-day irritant to the Okinawa residents than the details of criminal jurisdiction. Is there anything that could be done in that respect?

Mr. ARMITAGE. I think very clearly it not only can, but it will be done. The consolidation of U.S. forces is a code word for turning over some land. And that is what you are hearing. And it not only could, it probably should be done.

Mr. BEREUTER. Thank you. Dr. Auer.

Dr. AUER. Yes, if I could just add a footnote to that. I agree with what Ambassador Armitage just said. But really that is a problem that the Japanese Government has to solve. We require certain facilities for training. Japan is providing those in Okinawa. If Japan provided adequate facilities in another area, I do not think the

United States would object. We are not insisting to be in Okinawa. That happens to be where the bases presently are.

Mr. BEREUTER. Do they have to be in Okinawa? They have to be in Japan.

Dr. AUER. Essentially, we want to operate in that part of the world. I visited Okinawa in 1987 and the then-present Governor, who was then a professor, attended a talk I gave. Essentially I talked about the importance of the U.S.-Japan security relationship. And he said, "I do not completely agree with what you say, but I understand what you say." But if it is that important, all of Japan ought to bear that burden, rather than pushing it all to Okinawa. Again, I think that is a problem that only the Japanese Government and people can solve.

Mr. BEREUTER. My time has expired, but I do remember Congress acting at the last minute to take advantage of the 50-year lease on Tinian, which is not in the immediate location, but not too distant, either. And it sits there largely unoccupied with old B-29 strips and so on. Since there is a very special relationship with the United States since its evolution from a trust territory status, I sometimes think of that as some alternative. Dr. Pyle, if you wanted to react to this before I turn to my colleague.

Dr. PYLE. Well, I just wanted to say that I think that it is important that we—Ambassador Armitage referred to my remarks as academic and grandiose.

Mr. ARMITAGE. Articulate.

Dr. PYLE. Articulate as well. But suggested that policy has to be made on a day-to-day basis and I understand that. But I think it is also important in order to garner support for the security treaty that we have a vision, a post-cold war vision of what we are doing in that part of the world in order to gain the understanding of the Japanese people, if not necessarily the Okinawans that bear the greatest burden, at least of the Japanese people of what our purposes are.

Mr. BEREUTER. I am glad I stimulated a little interaction here. Mr. Faleomavaega.

Mr. FALEOMAVAEGA. Welcome to Ambassador Armitage. I have had the privilege of hosting him a couple of times in his visits to the Pacific. I personally welcome Mr. Armitage to our committee this afternoon.

I am taken by some of the comments that have been made by our distinguished panel. Mr. Armitage uses this wording "KISS". I guess to the sailors it means keep it simple sailor, but I have also heard it said keep it simple stupid.

Mr. ARMITAGE. There are even more scatological references, but in deference to the committee—

Mr. FALEOMAVAEGA. I was taken by Dr. Auer's statement as a formal naval officer running ships between Japan and the Philippines. The thing that interested me is that some of the national leaders of the Philippine Government the times that I visited them said that at least their biggest complaint to the United States, our presence there in Subic Bay and Clark Air Force Base was not to protect the Filipinos, but was to maintain the defense system for Japan. In fact, that was probably one of the reasons why a lot of the Filipinos did not appreciate having our military presence there

because it really was not to protect them, but it was to protect the Japanese.

I get the impression that it seems that we are picking on Japan; I guess this mindset that as a people they are not to be trusted. It is almost like an American Indian saying that walk in a man's moccasins for 2 weeks and you can better sense—appreciate what the Japanese have gone through.

As you gentlemen know, the French Government has come up with the most ridiculous policy of resuming nuclear testing in the South Pacific. As you well know, some 160 nations, including Japan, vigorously protested this absolutely stupid and asinine practice by a so-called Democratic country to explode eight more nuclear bombs in the middle of the Pacific for some real stupid reason as far as I am concerned. In fact, even the Minister of Finance from Japan I admit 2 months ago was there when we were there protesting this French nightmare that is causing the nations of the Pacific as well as in Asia some very serious concerns.

My question is, and Japan I should rightly think and I think Dr. Pyle has some very interesting comments to this, we are looking at Japan with concern about nuclear capability. If I were Japanese, I would be very concerned of the fact that China is conducting nuclear testing right next door.

By the same token, the French are doing this and as far as I am concerned the French have just enhanced nuclear proliferation by conducting these nuclear tests in the Pacific. Because if I were Chancellor Kohl in Germany and Europe, I would feel very uneasy if Chirrac has got that nuclear button never knowing whether that button is going to be directed toward Bonn or Munich or Berlin.

And I wanted to ask you gentlemen on this whether it be on a bilateral basis, even on a regional basis, the same token that Japan and Germany are being seriously looked upon for permanent membership in the Security Council. Should Japan and Germany also be given the same privilege of being members of the nuclear club as the five permanent members of the Security Council? I want to ask you gentlemen for your comments on that.

Mr. ARMITAGE. Well, I certainly would endorse Japan and Germany as joining members of the Security Council. I would also work assiduously to try to dissuade them from any nuclear weapons capability.

Mr. FALEOMAVAEGA. Japan, I understand, currently has the third largest budget for its military expenditures in the world.

Mr. ARMITAGE. It might even be the second.

Mr. FALEOMAVAEGA. It is now the second. Here is another contradiction that really puzzles me, gentlemen. And you are experts. We outlaw germ warfare, nuclear, biological, chemical and yet we do not outlaw nuclear explosions or nuclear bombs. But please, I am sorry. I did not mean to get into, I am giving you so many questions. I have got so many on my mind, but could you respond to my first question?

Mr. ARMITAGE. Yes, sir. I believe that a majority in Japan would still rather rely on the United States as the nuclear umbrella than have their own independent nuclear capability. This will work as long as there is a strong relationship of trust between the United States and Japan. Similarly, I support permanent membership for

Japan on the U.N. Security Council, but only if Japan agrees to engage in military peacekeeping operations the way other permanent members of the National Security Council do.

There has been a request by the present Japanese Government that it be allowed to become a permanent member, but be exempt from any type of military peacekeeping missions. They will participate in humanitarian missions. I think if Japan were allowed in on that basis, no one's national interests, including the Japanese would be served. It would be like the Persian Gulf War. Japan might give a lot of money, but Japan's efforts would not be appreciated.

Mr. FALEOMAVEGA. Dr. Pyle.

Dr. PYLE. You raised a very interesting issue, I think, when you mentioned Chinese nuclear testing. I think the Japanese are increasingly worried by being next door to a country that is going to go through industrialization in the space of a generation. What all that means, not only for military power but for environmental degradation, all kinds of things. And I think this makes an argument why we should try to draw Japan into a much closer and more active role in defense in the Pacific. Otherwise, we will be left alone to carry the burden of containing potential Chinese military power in the future and I think we will regret not having had the foresight to bring Japan into much closer military cooperation.

Mr. FALEOMAVEGA. Would you agree, gentlemen, that perhaps some of our policymakers, not only in our own country, but other countries as well by real serious implication ever since the bombing of Pearl Harbor, that seems to be our mindset. And is this fair for the Japanese that this kind of label should always be by implication that they are not to be trusted because of what the military regime did this in World War II. I am very concerned. I mean, no different than what Hitler did in going against whatever treaties or whatever agreements they impose on this. I wanted to carry further the thought that Dr. Pyle has said this, burden sharing. Should Germany be treated the same way because that seems to be the same label that we seem to imply that these two super powers are not to be trusted?

Dr. PYLE. There is a critical difference though, Congressman, because Germany was brought into NATO very early in the post-war period, whereas Japan stayed out of collective security. So Japan is really far behind and we need to, in my judgment, try to make up for that. A lot of people seem to believe that Japan has a kind of gene that makes them militaristic or aggressive by nature. I think that is a misreading of the long history of Japanese civilization.

Mr. FALEOMAVEGA. Not only that, Dr. Pyle, but I consider that a very wrong mischaracterization of a people. I mean, this is no different than what we did with the American Indians and our policies have been toward the Indians and the hundreds of treaties that we have signed and we have broken every one of those treaties. And so I just want to get a real fair statement from you gentlemen because I think it is an unfairness to Japan to think that these people are not capable of even handling nuclear things if it was necessary in their national interest that they need to, to possess these armaments, if necessary, to protect themselves.

Mr. ARMITAGE. I might add in fairness, Congressman, all or most of us have been contributing to the increase of cynicism that surrounds Japan. I think it is unfair. I personally do not distrust Japan. But policymakers, Members of Congress, and Japanese leaders for years have engaged in a cynical game wherein Japanese leaders privately tell us they need gaiatsu, outside pressure, to do something that they know they ought to do and that would be in Japan's national interest. And this kind of activity or game we have played wittingly with successive Japanese leaders has induced a lot of cynicism on this part of the ocean and I think not a little in Japan.

Dr. AUER. If I could just follow that up, I also agree. I tend to think if Japan were a nuclear power, having been the only nation that ever experienced such an attack, I think they would be a very careful and responsible one. However, Japan, with encouragement from the United States, has ratified the NPT and, as long as there is a strong relationship of trust between the United States and Japan, I think most Japanese would rather rely on the United States than have their own independent nuclear arsenal.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman. Thank you, gentlemen.

Mr. BEREUTER. Thank you very much. It does seem to me that a lot of concerns about the Japanese as you describe them are self-identified by the Japanese, and that has some impact on the rest of the world.

As I conclude this hearing, I want to mention that on Monday in this hearing room again at 2 p.m., we will take a look in the second round of hearings at Japan's uncertain politics and particularly the current banking problems. We will focus more narrowly then on political change and instability and their implications for U.S.-Japan relations, as well as the prospects for particular areas like deregulation and rate liberalization. We will also examine the financial crisis and prospects for resolving it, including its impact upon the U.S. banking and financial system.

To our witnesses, you have been very helpful to us. You have stimulated our thoughts. We look forward to digesting your written testimony more thoroughly than we have had a chance to do today. I want to thank you for your effort in coming here and readjusting your schedules to our new hearing date today. Thank you, gentlemen. Thank you very much.

Mr. ARMITAGE. Thank you, Mr. Chairman.

Dr. AUER. Thank you, sir.

Dr. PYLE. Thank you.

Mr. BEREUTER. This hearing is adjourned.

[Whereupon, at 4:28 p.m., the subcommittee was adjourned to reconvene jointly with the Subcommittee on International Economic Policy and Trade at 2 p.m. on October 30, 1995.]

JAPAN'S UNCERTAIN POLITICS AND ECONOMY—PART II

MONDAY, OCTOBER 30, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND
TRADE, AND
SUBCOMMITTEE ON ASIA AND THE PACIFIC
Washington, DC.

The subcommittees met, pursuant to call, at 2 p.m. in room 2172, Rayburn House Office Building, Hon. Doug Bereuter [Chairman of the Subcommittee on Asia and the Pacific] presiding.

Mr. BEREUTER. The subcommittees will come to order.

Today's hearing is a joint hearing of the Subcommittees on Asia-Pacific and on International Economic Policy and Trade. This is the second of two hearings of the House International Relations' Subcommittee on Asia and the Pacific on the subject of U.S.-Japan relations. We should be relatively uninterrupted today, I would hope, because we are not scheduled to have any votes until 5 p.m. But unfortunately on these Mondays that also means many members are coming back from their districts, and I know that is the case with our ranking member, Howard Berman, Representative from California, who would have liked very much to have been here. I will submit all members' statements for the record. On one, maybe two, occasions, I will have to go to the House floor and speak on legislation that is pending today, and I hope we can continue during that period of time, during the question period, with another member taking the Chair.

The first hearing of the two that we held considered U.S.-Japan relations from the perspective of a broader American interest in Asia, after the end of the cold war. Although the hearing also addressed U.S. economic interests in Asia, including our stake in the Asia Pacific Economic Cooperation Organization, or APEC, both the Administration and private witnesses focused most of their attention on U.S. regional security interests and the United States and Japan security alliance.

Today's hearing, which I mentioned is a joint hearing with the Subcommittee on International Economic Policy and Trade, chaired by my distinguished colleague, Representative Toby Roth, of Wisconsin, will focus primarily on political change and on uncertainty in Japan and its implications for U.S. trade and economic interests.

Because of our prior hearings, I have asked the witnesses to concentrate their remarks primarily on the implications of political uncertainty in Japan for our bilateral economic relations. However,

they are certainly welcome to comment on security matters or on the interaction of security and economic issues, if they wish.

Some specific interests of our two subcommittees include the effect of political change in Japan on Tokyo's responsiveness to U.S. market opening pressure; prospects for economic deregulation; economic growth prospects; and the current crisis affecting Japanese financial institutions.

We would also welcome an evaluation of how well the U.S. Government has handled its trade relations with Japan in recent years and any suggestions on strategies for dealing with Japan on trade and economic issues in the future.

The sudden collapse in mid-1993 of 38 years of single party dominance by the Liberal Democratic Party, the LDP, took most observers by surprise. The last LDP Government, headed by Prime Minister Kiichi Miyazawa, fell when reformist members bolted the party and joined with the opposition on a vote of no confidence. Essentially, it would seem the party split because it could not reach internal agreement on a plan for political reform.

Since mid-1993, Japan has had three successive coalition governments. The first two were based on a disparate alliance of non-LDP parties, including new parties formed by ex-LDP members. The current government is an unlikely combination, I would think, of the LDP, its former ideological rival, the Socialist Party, and a minor party headed by the current Minister of Finance.

Prime Minister Tomiichi Murayama is the first Socialist Prime Minister since the immediate post-war period. However, the Socialists were the biggest losers in the July 1993 Lower House elections, which cut their representation in half. Largely because of their out-dated ideology, their compromise of marriage of convenience with the LDP and the adoption of a new districting system for the election of the Lower House Members, the Socialists are widely regarded as facing extinction.

Cabinet instability and political disarray in Tokyo have created a number of complications in U.S.-Japan relations. Most of Japan's half dozen or so parties currently profess to support deregulation and other reforms that would promote market openings, but these goals have been more honored, I would say, with rhetoric than action.

Strong vested interests, most notably Japan's farmers, have continued to block trade liberalization. Japan's always powerful bureaucrats meanwhile have gained even more power as political instability has weakened the elected leaders. The bureaucrats have mounted a largely successful defense against sweeping deregulation and administrative reform and have dug in their heels against U.S. pressure on market opening.

I noticed one of the witnesses' testimony gave me some cautionary notes on comments like that, but we will let them speak for themselves.

Since all of the parties are uncertain of their prospects in the next national elections, none of them are seen as willing to support decisions that harm important constituencies. Some things are transnational.

As another consequence of domestic political weakness, Japan's economy has seen virtually no economic growth for the last 3 or 4

years. Japan remains in the midst of a very serious financial crisis, for which a collapse of property and stock values since the end of the late 1980's bubble economy has created a mountain of bad debt. It is estimated that the banking industry is presently saddled with some \$400 to \$800 billion worth of nonperforming loans. Unrelated to a larger crisis, U.S.-Japan relations have been strained over a loss of some \$1.1 billion from unauthorized trading by an employee of the Daiwa Bank in New York. The one thread running through the sluggish economy of the bank crisis is the powerful and seemingly omnipotent Ministry of Finance. The ministry's powers reportedly have increased in proportion to the weakness of Japan's elected leadership.

It is improper to compare, as I think one of the witnesses suggested, the power of the Department of the Treasury in this country with the Minister of Defense, a much more powerful entity across the spectrum.

Not always have developments been negative. As a price of participation in the governing coalition, the Socialists have dropped their opposition to U.S.-Japan security alliances. The United States and Japan have reached a number of trade accords during the past 2 years, although the jury is still out on the effectiveness that they will have in increasing U.S. exports.

From a simplistic, purely American point of view, there is some reason for optimism in examining recent monthly trade figures which are starting to show a narrowing of the \$60 billion-plus U.S. trade deficit with Japan. Japanese figures for September showed a 19.3 percent rise in imports from the United States and a 3.8 percent fall in exports to the United States. The past 6 months, exports of Japanese automobiles to the United States have fallen by 13.6 percent. Economists, however, generally remain cautious about how long these trends will persist, and so should we. Beyond the direction of these figures, we need, I believe, to focus on the causes of these trade trends to decide whether or not these changes are good or bad overall for America.

We have a very distinguished group of panelists to assist us in addressing these issues today. Our first panelist will be Dr. Robert Feldman, who is Managing Director and Chief Economist for Japan with Salomon Brothers Asia Ltd. in Tokyo.

Dr. Feldman is one of the most knowledgeable and most often quoted American analysts of Japan's politics and economy. We are fortunate that his previously planned trip to the United States has coincided with this hearing. I appreciate his willingness to rearrange his program to be here today.

Our second witness will be Dr. Leonard Schoppa, who is an Assistant Professor in the Department of Government and Foreign Affairs at the University of Virginia, where he teaches courses in Japanese politics and foreign relations. He is the author of a very relevant forthcoming book from Columbia University Press entitled "Bargaining with Japan: What American Pressure Can and Cannot Do." This is a study of U.S. trade negotiations under the Bush and Clinton administrations.

Our third witness will be Professor Merit Janow from Columbia University. Professor Janow teaches graduate courses in foreign

economic policy and international trade law at the School of International and Public Affairs at Columbia University.

From February 1990 through July 1993, she served as Deputy Assistant Trade Representative for Japan and China. She participated in the Bush administration's Structural Impediments Initiative, SSI, talks, which sought to lower trade barriers through fundamental changes in Japan's regulatory and administrative system.

It is worth noting that the SII approach was rejected by the Clinton administration in pursuit of a so-called results-oriented approach, featuring numerical targets. I look forward to hearing the views of both Professor Janow and Professor Schoppa on the comparative merits of these two approaches, as well as the comments of the other witnesses.

Finally, we will hear from Dr. William Farrell, who is an Advanced Research Fellow at the Harvard University's Program on U.S.-Japan Relations. Dr. Farrell also brings to the hearing a deep knowledge of Japan and a wealth of experience on the practical side of trade relations. Prior to going to Harvard, he was Executive Director of the American Chamber of Commerce in Japan.

I am joined by my colleague from Illinois. Would you like to make any opening statement?

Mr. MANZULLO. Thank you very much, Mr. Chairman.

It is a real pleasure to have you here this afternoon. The area which I represent is heavily industrialized and it is probably one of the most exporting congressional districts in the country. That is Rockford, Illinois, which exports about 15 percent of all of the tool and dyes exported in the entire country. This congressional district has significant interest in Japan and we are very much interested in hearing your testimony and things that may or may not be accomplished.

I guess what I am trying to say is that we need your input. The manufacturers of this country are very much interested in maintaining a very stable and meaningful relationship with Japan and we look forward to your testimony. Thank you.

Mr. BEREUTER. Mr. Manzullo, thank you very much. I am a strong advocate for the export base of your district and State and I appreciate your participation here today.

So with no further ado, I would like to call upon our witnesses for their testimony.

Your entire statements will be made a part of the record. I would ask you to try to summarize in about 8 or 10 minutes. Read and summarize as you see fit.

First, I will call on Dr. Feldman. You may proceed as you wish.

STATEMENT OF DR. ROBERT ALAN FELDMAN, MANAGING DIRECTOR, SALOMON BROTHERS ASIA, LTD., TOKYO, JAPAN

Dr. FELDMAN. Thank you very much, Mr. Chairman.

Mr. Chairman and members of the committee, let me first express my thanks to the committee for the opportunity to testify. It is an honor.

Let me add that the views I express today are my own and not necessarily those of Salomon Brothers.

Japan has undergone a momentous but incomplete change in its political system. Many Japanese, as well as foreigners, have been amazed at some of the developments. For example, as you mentioned, Mr. Chairman, the LDP split and then lost power for the first time in 38 years. Mavericks have won Governorships in Japan's two most populous prefectures. The LDP and the Socialists, arch rivals for so many years, are in a coalition. Japanese to some extent feel betrayed just as Americans would if Speaker Gingrich and President Clinton ran on the same ticket.

What has brought about all of this change? What are the possible political scenarios for the future? What does it all mean for economic policy and performance? How will U.S.-Japan relations be affected?

Let me try to answer these questions.

There have been, in my view, four sources of change in Japanese politics. The first is a change in the calculus of consent because of the end of the cold war. During the cold war the Japanese electorate put up with corruption and an undemocratic representation system as a cost of the U.S.-Japan alliance that defended Japan from the Soviet Union. Now, the tradeoff has changed and so the voters are less willing to endure the costs of the old system because its benefits are no longer needed.

Second, politicians themselves realize that the old system virtually forced them into gray areas of political funding. They got sick of being condemned for actions that the system forced them to take.

Third, voter turnout declines showed a waning of the democratic spirit; very dangerous in a culture where the tradition of saying no to leaders is less well-rooted than in our own. And fourth, recession stopped the flow of corporate campaign contributions.

What does the new system look like?

Well, for one thing it is more democratic. Under the old Diet system, rural regions had 48 percent of the seats in the Diet and urban regions, 52 percent. Under the new system, the rural regions have only 42 and the urban regions 58 percent. A margin under the old system has turned into a chasm under the new.

In addition, the multimember district system which encouraged politicians to promote different factions within one party to compete against each other has been changed. This change should reduce corruption because the new system should be cheaper, and funding laws were revised so that the faction system itself has collapsed.

The main result of all of this change has been an increased focus on policy in election campaigns. The breakup of the LDP and the election of Morihiro Hosokawa as Prime Minister was based on Mr. Hosokawa's presentation of a clear policy platform of deregulation and federalism.

More recently, the election of Yukio Aoshima as Governor of Tokyo was based on the declaration of two policy principles: Reduced bureaucratic waste and no bailout for S&L crooks. Oddly, at the national level the main parties have reacted to this new focus on policy by trying to avoid a general election.

The national level politicians are scared for several reasons. They are not fully organized for the next election. They do not know

what policies the people actually want. They have little experience in campaigning on policy platforms, and they do not know how the new districting system will translate votes into Diet seats. And so the conclusion, particularly on the part of the ruling coalition, is: Let's wait. Events, of course, may derail this strategy, and I am advising my clients to be ready for a general election at any time.

What are the potential outcomes of this upcoming election?

The first step in answering this question is to create a framework for analysis. In my handout, the easy part is done. I have a little diagram that I hope will clarify my approach. Please look at Figure 62 on page 29. This figure shows what I believe are the philosophical fault lines in Japanese politics today.

The first is economic policy. The horizontal axis in this diagram represents a spectrum from dirigism, or heavy government intervention, to *laissez-faire*.

The second axis concerns foreign policy. The vertical axis represents the spectrum from an activist policy to a passive one. One might term the extremes hawks and doves, but a cynic might also term them eagles and ostriches. Regardless of metaphor, the four combinations seen there are the ones that are possible. I have placed certain leading politicians' names in the various quadrants in order to facilitate understanding.

Applying this framework to analyzing the election outcome is the next step and a difficult one. For the reasons I mentioned, politicians do not wish to be classified. We don't know the distribution of voters among the quadrants and we don't know how the new district system will translate votes into seats. But we do know the most likely potential coalition between the various quadrants, and on this basis we can make some meaningful, although general, statements about resulting economic policies and their implications for U.S.-Japan relations.

The first possible outcome is an outright victory by the LDP. This would put the country squarely in the dirigist hawk quadrant. Fiscal policy would be very stimulative and would focus, as always, on construction projects and agricultural subsidies. Deregulation policy would go slowly. Even though LDP President Hashimoto claims to favor deregulation, his recent campaign speeches emphasize the need for consensus with the bureaucracy in devising deregulation policies. I would expect only timid deregulation moves under an outright LDP victory.

The second possible outcome is a so-called double conservative alliance. This would put the dirigist hawks and the *laissez-faire* hawks together in a coalition. Fiscal policy would be stimulative, although more concentrated on tax cuts and urban welfare policies. Deregulation would be somewhat more aggressive, although still constrained by the dirigists in the coalition.

The third possible outcome is a reformist government, that is, a coalition of the *laissez-faire* hawks and the *laissez-faire* doves. Fiscal policy would still be aggressive but tax cuts and welfare would replace much of the construction and agricultural subsidy structure seen in the last 40 years. Deregulation would be much more aggressive, not out of altruism of the politicians and bureaucrats but because the urban support base for the politicians demands it.

One word of caution. The Japanese economy in 1996 is not likely to be affected much by the election outcome even if the election occurs earlier than the springtime now seen as most likely. So the economy in 1996 is expected to follow a pattern of improved growth fueled by fiscal stimulus but little supply side improvement. For details of the economic outlook, please see the text of, "The Easy Part is Done".

Let me now turn to some observations on how these scenarios might affect U.S.-Japan relations. In the realm of economic policy, I believe that an aggressive deregulation in Japan would be in the best interests of the United States. First, it would give improved access to U.S. products. Equally important, it would improve the efficiency of the Japanese economy and thus create demand for the rest of the world. And third, aggressive deregulation would correct the overvaluation of the yen and thus encourage Japanese capital to flow more freely abroad and raise growth in the rest of the world.

You raised, Mr. Chairman, the question of the Japanese financial system and its importance at this point. Let me only refer to the text of a statement made 2 weeks ago before Congress by my colleague, Alicia Ogawa, in a similar hearing. I can be no more precise or succinct than she was in that statement, so permit me to read one paragraph from that again.

I should like to state at the outset that I believe that the situation of the Japanese financial industry does not constitute a crisis if by crisis we mean a condition of extreme instability posing an immediate threat to the economy. Certainly, there is enough money in the national coffers to purchase even the most pessimistic estimates of nonperforming loans or to otherwise recapitalize the banks. There are no signs of deposit flight or other serious concerns on the part of domestic clients of the major banks. Neither will foreign financial institutions face any risk of default by major Japanese banks if we take the Ministry of Finance at its word when it has explicitly promised that internationally active Japanese banks will under no circumstances be liquidated. Finally, it is my impression that the domestic authorities have finally reached the conclusion that the usefulness of the approach taken to date is limited and that more aggressive measures will be implemented shortly.

So in the realm of economic policy, as I was saying, an aggressive deregulation and a more aggressive stance as taken in these financial matters is in the best interests of the United States.

Now, in the foreign policy realm, I believe that a more hawkish stance by Japan best serves the United States also for two reasons. First, the so-called hawks are not hawks in any nationalistic sense of the word but rather those who seek an active engagement by Japan in the many global issues that face us such as poverty, disease, population control, environmental degradation, and war. Just as in earlier fights against fascism and communism, America cannot handle today's global problems alone. We need help and Japan can give it.

Second, a healthy skepticism about our own democracy suggests that a hawkish Japan can actually help us. We should welcome a strong stance by Japan against attempts by special interest groups in the United States to distort our own economy and the world trade system. A tough Japan helps us improve our own economic efficiency and helps us keep trade free.

One crucial but often overlooked point in how we influence Japan is that of moral authority. Because we cannot directly participate

in the selection of Japanese leaders and policies, our influence must work through the power of our ideals and our integrity. St. Francis once said, "Preach the gospel at all times and use words, if necessary." His point was that the best pedagogy is example.

Halloween is a grim reminder of this to both me and to many Japanese. You may recall that a few years ago, a 16-year-old Japanese student was killed on Halloween night and his killers were acquitted. In my view, we have betrayed that boy's trust in America and then robbed his death of meaning. I met the boy's father a few weeks ago. I felt not only grief but shame, shame in America's poor record of public safety and shame in a legal system that abets such outcomes.

This tragedy makes an important point about U.S.-Japan relations. Reestablishing our moral authority is key to winning the hearts and minds of the Japanese people and only then will they support our efforts in solving global problems.

Let me summarize by making two points for U.S. policy. The first is to identify and encourage forces in Japan that will take an energetic stance on global issues and an aggressive stance on deregulation. The second is to preach our own gospel without words.

Thank you.

Mr. BEREUTER. Thank you very much, Dr. Feldman.

[The prepared statement of Dr. Feldman appears in the appendix.]

Mr. BEREUTER. For the record, I would note we were joined by our colleague from Ohio, Mr. Chabot, about 5 minutes ago or so. Welcome, Steve.

Mr. CHABOT. Thank you.

Mr. BEREUTER. Next I would like to call upon Dr. Leonard Schoppa from the Department of Government and Foreign Affairs at the University of Virginia.

Please summarize or read as you see fit. Welcome.

STATEMENT OF DR. LEONARD SCHOPPA, ASSISTANT PROFESSOR, DEPARTMENT OF GOVERNMENT AND FOREIGN AFFAIRS, UNIVERSITY OF VIRGINIA

Dr. SCHOPPA. Thank you, sir.

Mr. Chairman and members of the subcommittee, I am pleased to have this opportunity to testify before your subcommittee on the implications of recent developments in Japanese politics for American interests.

As you know, there have been many changes in Japanese politics over the past 2 years. First, the long-ruling LDP was tossed out of power in the summer of 1993, replaced by a series of weak and unstable coalition governments. Second, the government adopted last fall a set of electoral and political finance reforms which were designed to dramatically change the incentive structure confronting Japanese politicians. Finally, Japanese politics has been affected by the end of the cold war, a shock to the system which has led many Japanese to take a critical look at foreign policy patterns which they took for granted for so many years.

All of these changes have implications for America's interests in its relations with Japan. While the changes have implications for U.S.-Japan security relations as well, today I would like to focus

my remarks on what they mean for the future of our bilateral economic relationship. In the short term, I will argue all three of these recent developments have adversely affected the ability of the United States to extract trade concessions from the Japanese in the manner to which we have grown accustomed over the last few decades. These difficulties were revealed in dramatic fashion this past summer, I propose, in the failure of the Administration to extract the kind of results-oriented trade deal it said it wanted from Japan on access of the Japanese auto and auto parts markets issues. In the longer term, however, the changes create opportunities for the United States to help open up the Japanese market.

Before looking at the recent changes in Japanese politics, I think it is important to pause and recognize how unusually effective American trade pressure has been over the past 20 years or so. On Table 10.1 and Figure 10.1, included in my formal statement, based on data presented in an Institute for International Economics study by Thomas Bayard and Kimberly Elliott, show clearly how Japan has been an "outlier" in terms of its responsiveness to U.S. pressure. Comparing the results on how successful section 301 agreements were across a range of countries, Japan shows up at the most responsive end.

These data suggest that America's success in using trade pressure to extract concessions from Japan may have rested on some special circumstances, circumstances that have changed, I propose, over the past 2 years.

First, our success rested on habits and attitudes formed during the cold war. Even as Japan grew in its economic power, the nation's officials, and even its politicians, continued to be content to play junior partner to America, partly because these elites matured and served during a period in which Japan's alliance with the United States was its only mooring in a hostile world. The deference bred into Japanese officials during this period made them more likely to give in to U.S. pressure. Equally important, Japanese trade negotiators could give up more on sensitive issues because they could always sell the sacrifice to the affected Japanese constituencies with the argument that it was necessary in view of Japan's dependence on the American security blanket.

While it took a few years after Gorbachev's arrival before the Japanese elites recognized the cold war was finally over, the realization that Japan is no longer dependent on the United States to shield it from the Red Menace has affected attitudes toward the United States very quickly. One hears and reads the term "post-cold war world" everywhere in Tokyo these days. The feeling that this change means Japan can now stand up to the United States and be more of a normal country seems to be particularly widespread. As Paul Blustein of the Post reported in May, this new attitude seems especially pronounced among younger officials in agencies like MITI. These officials are no longer inclined to give into the United States out of deference. They also have a harder time selling Japanese constituents on the need for sacrifice in the name of the U.S.-Japan alliance when it is no longer clear what purpose the U.S. military forces in Japan serve.

The effectiveness of U.S. pressure was also served, however, by the way this pressure became, over the course of the LDP's long

rule, a sort of necessary evil which was vital to the smooth functioning of the system. Partly because the LDP, as the only game in town, represented all of the special interest groups with a stake in the status quo, and partly because the old electoral system created strong incentives for politicians to cater to vested interests that could deliver organized groups of voters and the funds necessary to win under the old rules, policy tended to change very slowly in Japan under the LDP unless there was a crisis. Inefficient protection of the agricultural market, irrational regulations, and unfair tax codes could not be touched unless these policies became subject to enough foreign pressure that a crisis could be declared so that the policies could be reformed.

Special interests and government officials favoring change in Japan knew that U.S. pressure, or *gaiatsu*, was the key to breaking the deadlock on many issues. LDP officials, too, didn't mind blaming politically difficult decisions on the Americans. Over time, the LDP regime came to depend on *gaiatsu* much as addicts depend on a drug, to borrow Glen Fukushima's analogy, to facilitate the process, we developed a real routine. We would approach the Japanese bureaucrats with a concern, they would protest that demands were unacceptable, the press would declare that U.S.-Japan relations were nearing a breaking point, senior LDP leaders would step in to mediate the dispute, and a partly successful agreement would be reached.

Domestic political developments since the summer of 1993 have disrupted this routine. With the LDP thrown out of power, we had to deal with a situation during the first year of the Framework talks where the usual suspects we called upon when our talks with the bureaucrats reached an impasse were not available to mediate. Furthermore, the familiar faces that remained (such as Ozawa) were too preoccupied with political reform to have any time or energy to devote to bilateral relations. Then, when we finally thought that we had found some politicians we could talk to within the Ozawa camp and restarted the Framework talks in May 1994, the entire crew was replaced by the motley coalition of the Socialists, LPD, and Sakigake, which is still struggling to hold itself together today.

One reason the Framework talks were postponed so many times and produced so little was because all of this political turmoil disrupted the nice routine which had developed during the LDP's long period of rule. It would be a mistake, however, to dismiss our difficulties during the Framework as a passing phase which, some might hope, will give way to a reassertion of old patterns once the LDP, or some other party, regains a stable hold on power.

What we need to recognize is that the end of continuous rule by the LDP has made *gaiatsu* much less of a necessary evil for Japan. Advocates of change within the bureaucracy and among interest groups now have an alternative to the United States. They can go to the opposition party, the New Frontier Party. Now that there is a domestic option, *gaiatsu* is seen as less necessary and so has become less legitimate.

Gaiatsu is also seen as less necessary now that the Japanese have adopted far-reaching electoral and political finance reforms. Ozawa had advocated these reforms as a means of helping Japan

wean itself of dependence on *gaiatsu* and other irresponsible aspects of the old regime. The new electoral rules featuring a mix of single member districts and proportional representation seats instead of the old multimember districts, remove old incentives for politicians to concentrate their efforts on the task of winning personal votes. By removing this incentive, which led many LDP politicians to organize expensive groups that could deliver the cash and votes needed to win under these rules, the reforms are supposed to encourage politicians to campaign for office through programmatic appeals to a much wider segment of the public. No longer beholden to interest groups like the farmers, small retailers, and construction firms, politicians will be able to push through policy changes that were impossible to achieve under the old rules, or at least that is the theory.

When and if all of this will actually come to pass is still a matter of heated debate in my profession of political scientists who study Japan. We will have to wait and see. In the short term, however, the only thing that has happened is that expectations have been raised by all of this attention to political reform. To the extent that some Japanese, and perhaps Dr. Feldman, actually believe the rhetoric and expect or hope that Japan will now be able to deal with more of its problems without relying on *gaiatsu*, they will be less receptive to U.S. attempts to intervene in the old ways. As one Ministry of Foreign Affairs official told me, "the day of *gaiatsu* has passed. The rice issue was really the last one where we really needed to use *gaiatsu*. The rest we can deal with on our own." With Japanese officials adopting such positions, it should come as no surprise that U.S. pressure tactics have been proving much less effective of late.

To recapitulate my argument thus far, all the recent developments in Japanese politics have served to eliminate the special circumstances which made American trade pressure unusually effective with Japan in the past. What this means is that we should expect Japan to move much closer to the regression line on Figure 10.1, moving from a position at the far extreme of responsiveness over more toward the EC and Canada, which we know from experience are not nearly as immediate in their response to American pressure.

In the longer term, as I mentioned at the start of my statement, some of the recent changes promise to ease U.S.-Japan trade friction. Most notably, if the new electoral and political finance rules affect politics in the way they were advertised, Japanese politicians will have greater incentives to push for trade liberalization than in the past.

As I noted, however, none of this is really happening yet. At this point, all we have from politicians is a lot of talk about deregulation without evidence that they are going to fight the bureaucrats and special interests to produce real policy change. Perhaps after a few elections under the new rules, some political entrepreneur will come along and see the opportunity offered by the new electoral rules. While this provides us with some hope for the long term, we all know the saying about how in the long run we are all dead. In the short term, the United States cannot sit idly and ignore continuing barriers to trade in the Japanese market. The fact

that changes in domestic politics means that the old ways of pressuring Japan are going to be less effective means, however, that we need to find new ways in which to keep up the pressure.

While the end of the cold war has diminished the ability of the United States to pressure Japan on its own, it has increased the legitimacy of international organizations like the World Trade Organization. Japanese officials told us repeatedly during the auto talks that these matters should be addressed within the WTO. We should call their bluff, taking advantage of the new dispute settlement mechanism wherever possible. Second, we should look for barriers in Japan which impose high costs on Japanese firms and/or consumers as in the case of the Large Store Law targeted during the SII talks, and a few of the other issues targeted during the talks with which Dr. Janow is involved.

Instead of attacking these barriers solely with threats of retaliation, as did the Clinton administration, we should make more of a PR effort to educate and mobilize those in Japan who pay the costs of protection. We should also emphasize the potential deregulation has to generate economic growth by eliminating inefficiencies, an argument with immense appeal after 3 or 4 years of recession in Japan. Over time, we might help create the atmosphere which will motivate politicians to take up our cause and work for liberalization without heavy-handed gaiatsu.

Thank you.

Mr. BEREUTER. Thank you very much, Dr. Schoppa.

[The prepared statement of Dr. Schoppa appears in the appendix.]

Mr. BEREUTER. Now, I call upon Dr. Merit E. Janow, Professor of International Trade, School of International and Public Affairs at Columbia University. You may summarize or read as you see fit.

STATEMENT OF DR. MERIT E. JANOW, PROFESSOR, INTERNATIONAL TRADE, SCHOOL OF INTERNATIONAL AND PUBLIC AFFAIRS, COLUMBIA UNIVERSITY

Dr. JANOW. Mr. Chairman, members of the committee. Thank you for inviting me to testify before you today. It is an honor to be here to offer some perspectives on some recent developments in Japan. I would like to summarize the written statement that I have prepared for the record.

Mr. MANZULLO. Doctor, could you pull that mike closer to you.

Dr. JANOW. Surely.

What I would like to do is briefly summarize the statement that I have prepared for the record. I have not consulted before this hearing with the other witnesses but I will be echoing several of the themes that they have raised.

First, I would like to offer a few overall conclusions and then discuss very briefly how I have arrived at them.

Japanese politics is very confused at the moment and it is apparent that it may take several elections before the situation stabilizes. It is not yet clear whether this period of political realignment will eventually lead to a more policy-oriented political process or one that revolves around more traditional matters such as local organizing skills and skills at mobilizing interest groups.

At least until the political situation stabilizes, I expect only modest steps likely to be undertaken to address the very difficult economic issues facing Japan today. Trade disputes are likely to continue, and I think disputes may even prove more difficult to resolve because the subject matters of those disputes is going to increasingly focus on private sector practices and will focus less on formal government barriers. There is also more resistance to U.S. pressure and at this moment more obstacles facing politicians in their efforts to exert political leadership on both domestic and international issues.

I think there are very important market-driven and demographic changes under way in Japan that over the medium term will cause a further opening and restructuring of that market.

Economic deregulation is one area where domestic and international interests overlap. It has diverse and widespread, although not uniform, support in Japan. However, there are also many cross-pressures on deregulation in Japan, and I believe that it is very important that the United States try and encourage an approach to deregulation that more fully integrates Japan into the global economy. In our efforts to do so, it is extremely important that we identify those groups in Japan that are likely to be supportive of changes that we seek and are likely to support changes that are in the interests of the United States, Japan, and the global economy.

Let me very briefly elaborate on these basic perspectives. There are three reasons why I think there will be only limited changes in the management and direction of Japan's political economy in the short run.

First of all, in general, I don't see much desire on the part of Japanese politicians to take on difficult issues that polarize voters. The major parties are both conservative parties and both are trying to appeal to the same voters and both are gearing up for the first major election under the new rules. Their slogans seem to be very similar to each other: the need for reform, growth, deregulation, and change. What specifically might be done to address Japan's nonperforming loans; a bold timetable on deregulation and other contentious issues don't seem to be center stage.

A second related issue is, I think, the absence of public sentiment insisting on the necessity of broad-based economic reform.

Voter dissatisfaction with Japanese politicians and bureaucrats is high, but this doesn't seem to be translating into a sense of crisis about the last 5 years of economic stagnation. For example, according to an August poll conducted by the Prime Minister's office, 73 percent of the respondents said that they were content with their current standard of living. This survey has been conducted annually since 1958, and the latest survey showed the highest degree of public satisfaction ever.

Now, if this is an accurate window into public attitudes, then one might reasonably wonder whether or not there really is sufficient public unhappiness with the current state of economic and political affairs to produce the kind of pressures necessary on politicians or bureaucrats to depart significantly from current patterns.

Third, at least in the near term, as you mentioned, Mr. Chairman, in your opening statement, bureaucrats are likely to exert even more than the usual control over the policy process.

Japanese bureaucrats are, indeed, the repository of expertise on economic and other policy matters. Almost all legislation is drafted by bureaucrats and goes to the Diet through the Cabinet rather than member bills. Interpellations from the Diet are usually defended by bureaucrats.

Political appointees to ministries are very few in number. While there are some prominent Japanese politicians who are arguing that politicians must become more expert on policy, at the moment existing practices show very little signs of changing any time soon.

Some observers draw the conclusion that politicians in Japan don't really matter because the bureaucrats are in charge. I think this perspective fails to pick up nuances very important to Japan's political economy and important to the resolution of U.S.-Japan trade disputes.

In my experience as a former trade negotiator for the U.S. Government, bureaucrats in Japan have difficulties resolving disagreements that cut across ministerial lines or that face strong opposition from private sector interests. This isn't surprising. Politicians have played an important role in brokering compromises in such circumstances in the past. At this time, when the power base of politicians is in flux, their ability to broker compromises between competing interests seems reduced. Thus, in the short term it seems to me that the political situation is a bit disheartening for the effective management of domestic or international economic issues. I draw perhaps a more positive conclusion about the longer-term changes under way in the Japanese economy.

There are some fundamental changes occurring as a result of demographics and I discuss this in more detail in the written statement.

But basically, you are seeing an aging of the Japanese work force and of the Japanese population. That means that if the economy is to grow, companies may then have to consider bringing in more workers, moving more operations abroad, hiring more women, allowing employees to retire later, or shifting employment arrangements. There is going to be more spending on infrastructure for the aged and a decline in the social security account. This is a very fundamental structural change.

More immediate pressures on the Japanese economy include the recession and the appreciation of the yen. These are market-driven pressures. What is interesting to me about these features is that they are straining traditional patterns of employment and accentuating distortions within the economy.

Employment adjustment usually occurs in recessions around the world. It has been fairly limited in Japan relative to the severity and duration of the recession. I have included numerous statistics in my written statement that illustrates these facts, the point being that although Japanese newspapers are filled with articles about companies cutting workers, the aggregate data suggests that Japanese firms still provide a corporate social safety net. There have been some layoffs but excess labor continues to be carried by com-

panies and companies are using a variety of techniques to try and continue to carry relatively less performing workers.

The appreciation of the yen has also added to Japan's corporate problems with the manufacturing sector, particularly manufacturing firms in the export sector, being forced to reduce costs to remain competitive. This is highlighting distortions within the economy with export-oriented firms facing the strongest pressures to adjust and adjusting the most. Firms in protected markets or sectors that produce nontradeable goods are not facing these same pressures and are adjusting less. Productivity gaps among different industries are increasing.

As a result of these factors, there is anecdotal evidence that these pressures are obliging firms to move offshore, straining inefficient keiretsu relationships, and creating some new import markets. And imports have grown, say, 11 percent compared to a year ago, even though demand has been flat.

There is also strong evidence of price disparities between internal and external prices. Even MITI has commented in its 1995 White Paper that, "In order to reduce the domestic external price gap, we must correct the gap in productivity which is brought about by anticompetitive and inefficient regulations and trading practices". This is an astonishing statement, almost an admission of responsibility by MITI.

I think all of these economic factors should create a powerful logic for economic deregulation. Deregulation has received renewed attention under the Hosokawa administration and there was much support for it. Diverse business groups have come out in support for it, numerous academics, and surveys show, for example, that a very high percentage of respondents are interested in deregulation.

On the negative side of the ledger, however, deregulation has powerful detractors. Labor groups, Japanese firms in protected areas, and government ministries that see their own authority diminished by deregulation are opposing it. So are some consumer groups that see deregulation as threatening or potentially threatening health and other safety concerns.

There is, however, a very vigorous debate under way on deregulation in Japan. It is important that we keep an eye on it. At the moment, the momentum behind deregulation has stalled, and its future direction is unclear but it could revive.

Let me briefly conclude by noting: Clearly, Japanese politics is in a state of confusion, and in this environment the bureaucrats are continuing to steer policy in a steady but predictively cautious manner.

With respect to the economy, there are some long-term trends that are causing an incrementally more open and changing economy. Bilateral friction is going to continue and, in my view, will intensify because the focus is increasingly going to be on private restraints and hybrid problems of government policies and private practices. The Kodak-Fuji dispute is one recent example of this.

There is also more resistance in Japan to foreign pressure. I think the resistance stems from a number of things: Loss of some direct controls over the economy, more resistance to U.S. pressure that can be characterized as encouraging the Japanese Government to be more heavy-handed at a time when there is interest in de-

regulation and a less intrusive government. Also in the absence of internationally agreed-upon rules on how to deal with business practices, there is more unwillingness on the part of the Japanese Government to take up such issues bilaterally; and, fourth, a bilateral negotiating dynamic that has failed to generate domestic support in Japan.

This will require policy adjustments on both sides of the Pacific.

I think the agreements reached bilaterally have for the most part been evolutionary rather than revolutionary. There has been more specificity sought and obtained in a number of the agreements, especially regarding government procurement practices. However, some of the tactics used by U.S. negotiators have been exploited by Japanese negotiators and alienated them and our other allies. We have seen the Europeans occasionally siding with Japanese bureaucrats in the name of "free trade".

So over the long term, in my view, progress in achieving expanded market access can only be assured if the market opening measures that the United States seeks are responsive to the problems and have domestic supporters in Japan. Supporters have surfaced in many instances in the past, most notably during the SII, and at other times more recently.

Deregulation offers a vehicle for channeling the complementarity of interests between foreign firms and governments and Japanese new to the market firms and consumers.

It is not clear that the path down the road of deregulation in Japan will necessarily help or be desired by Japan's major trading partners. Japan is in many ways a bureaucratic society and it is likely to remain more regulated than other countries, even after deregulation. Deregulation is no panacea. But in conclusion, it seems very important to me that U.S. policymakers seek to ally with those groups in Japan that are supportive of changes that are in the interests of the United States, Japan, and the global economy. Thank you.

Mr. BEREUTER. Thank you very much, Dr. Janow.

[The prepared statement of Dr. Janow appears in the appendix.]

STATEMENT OF DR. WILLIAM R. FARRELL, ADVANCED RESEARCH FELLOW, PROGRAM ON U.S.-JAPAN RELATIONS, HARVARD UNIVERSITY

Mr. BEREUTER. We will now hear from Dr. William R. Farrell.

Dr. Farrell is an Advanced Research Fellow with the Program on U.S.-Japan Relations at Harvard University.

You may proceed as you wish, Dr. Farrell.

Dr. FARRELL. Mr. Chairman, thank you very much, members of the committee. Batting cleanup, depending on whether you are a Cleveland Indian or an Atlanta player, could be to your detriment.

Most of what I have been thinking and put into my statement has been said by the other panelists, but I would like to give you my interpretation of it.

I say this having lived in Japan for 12 years over the past 25, and most recently with the American Chamber of Commerce for 5 years. We have 700 U.S. companies, about 2,500 members as individuals combined, service industry, manufacturing industry, large

and small, long-term and those just coming to the market. So it's a diverse group of individuals.

One of the things that has struck me about U.S.-Japan negotiations is that both sides have engaged in a form of mirror imaging, creating expectations that impact across issues anywhere from auto parts to pharmaceuticals. We have some expectation in the United States that somehow a Prime Minister can behave like a President; that your Congress is similar to the Diet, their legislative body; that, after all, bureaucrats are bureaucrats, wherever they are; that customers and consumers are the same. But I think there are significant differences in the way the Japanese institutions behave and our expectations for those institutions that cause problems.

Institutionally, the Prime Minister is much weaker, oftentimes chosen not because he is a leader but because he is not a leader. The Japanese Diet in no way has the strength and the influence of the American Congress, mainly because it has very little information. There's no Diet research office. There's no Diet budget office.

A lot of the committees and staffing that this institution has to gain information, therefore to balance and assume its responsibilities vis-a-vis the executive branch, does not exist. That's why, as it was explained, you have bureaucrats coming from the Ministry basically writing the laws and defending questions from politicians about the laws.

There is a great deal of bureaucratic bashing that's in fashion in Japan right now, but I think that's very much treating the symptom of a disease. The real disease is there's no political center strong enough to exercise its influence over the bureaucrats in a sustained way.

You mentioned in your opening comment, Mr. Chairman, about the Ministry of Finance being very different from our Department of Treasury. In fact, the Ministry of Finance is a combination of the Treasury Department, the Federal Reserve, the Federal Deposit Insurance Corporation, Office of the Comptroller, and Security and Exchange Commission rolled into one. Therefore, it raises money and it spends money. If you are looking for the big fellow on the block, I would say that is the Ministry of Finance, a very, very important organization.

We also expect that our bureaucrats can do battle with their bureaucrats, but oftentimes the Japanese senior negotiating official has been part of the same Ministry for perhaps 30 years. He may have been a notetaker during negotiations with Wilbur Mills and is now sitting at the front of the table in negotiations with Ambassador Kantor. And they may both be very bright, talented people, but one has a lot more information about the history of the negotiations.

In fact, the Japanese think that we, in America are, frankly, nuts, that every 4 years, if we have a new Administration, we take out about 3,000 assistant secretaries of anything or something and have a major overhaul on the top of the bureaucracy. That would be terrible instability from their point of view.

We also seem to think that a Fair Trade Commission is a Fair Trade Commission and is going to promote fair trade. Recently, the Fair Trade Commission indicated that NTT, which has about 93

percent of the telecommunications market, does not fall under the anti-monopoly law and that the answer is increased deregulation, not the breakup of NTT.

You also see headlines where the Fair Trade Commission has struck out against collusive practices on overseas development assistance, going after 37 major companies to include some of the major trading firms; \$16.9 billion in business, but the largest fine for any of the companies was 1,200,000 yen or 12,500 U.S. dollars. That's not a disincentive to do business, especially if you consider a few weeks of entertaining expenses in downtown Tokyo. It's the cost of doing business.

Most of the complaints of American business and the reason that we seek the help of the Japanese Government—or, I mean, excuse me, we do request the help of the Japanese Government but we receive the help from the American Government—deals not with consumers, which are individuals who make choices, but more with customers such as NTT or the automobile industry or a pharmaceutical industry, where a bulk of the trade red ink takes place. So it's dealing with those customers and their business relationships in Japan that is the biggest difficulty.

What makes it difficult getting a response to you as to trade incentives or pressure—most recently, is that it is very hard to find out who is in charge in Japan. This coalition government, where you have three parties hanging together because they want to stay in power in one form or another as the overriding interest, is not an organization in which you can find a single individual who will ramrod and force the government to go a particular way.

In the good old days of the LDP rule, the party President happened to also be the Prime Minister. And, generally, if they made a commitment to do something, you could expect that there would be some form of follow-through.

Right now, the overriding concern is staying in power. I am not so sure that electoral reform will be the type of reform that cannot be gotten around in fund-raising and other activities. As I said, as was already said earlier, there is more rhetoric than reality at this particular point.

Concerning the Japanese economy, I think it would be very premature to start hanging the crepe. They talk about hollowing out in Japan but, to my knowledge, only about 7 percent of the Japanese manufacturing industry is taking place overseas. In the United States it is closer to 22 percent.

If you look at the employment figures within the manufacturing industry, despite the recession, there has been a slow and steady increase of workers in the manufacturing industry. This is according to a Bank of Japan statement just recently released, approximately .9 percent increase, but it is not a mass layoff. When Nissan closed a factory, it was big news in the United States. They are just like us. But they found jobs for a lot of their people and they relocated—as opposed to throwing a bunch of people out of work.

There are banks in trouble, but the biggest bank in Japan is the Postal Savings Organization, and the Japanese savings rate, despite the recession, has been increasing. That is a lot of money coming in for the government to use. And the Japanese have demonstrated an ability to compete at 90 yen to the dollar, some even

say 85. Just think how good they can be at 110 or 120, and that may be what we will be facing in the next few years.

I think it is important, when the need arises, American business can count on the American Government to support it. I think we in the American Chamber in the past, since I can't speak for the organization right now, worked very closely with the USTR Office, Members of Congress and their staffs when they visited Japan.

I think the semiconductor agreement was an important agreement, because it forced, quite frankly, businesses both in Japan and the United States to come together because, they were forced to come down the aisle together. But in the past 10 years there have been some very positive business relationships that have developed, despite all the screaming about Motorola forcing its way into the Japanese economy. And there was a lot of government encouragement for negotiation between Motorola, IDO and the regulators in Japan. Everybody is doing quite well now.

The next day approximately seven Japanese companies with the so-called Motorola Telephone System had full-page ads selling phones. The cost has come down, and it is an indication that deregulation is in everyone's best interest. There has been certain improvement where the U.S. Government has helped with asset management, medical equipment and others.

So the role of government of getting business together to work out the details and help following up in the implementation and ensuring implementation I think is very, very important. Once the agreement is signed, it is not an indication that the problems are solved. The implementation process, I think, becomes very critical.

I think Japan's current problems are self-inflicted. It is handy to point to the yen, but I think the high yen has a lot to do with Japanese policies.

Looking to the future, the hard part is trying to look at commercial rivalry and not some form of antagonistic economic warfare. We can have commercial rivalry without economic warfare.

I think we need to look at the U.S.-Japan trade relationship not as a zero-sum game. Somehow if the Japanese economy is in trouble then—and the Americans are doing well—that is good. The truth of the matter is, it is important for both of us to do well.

Finding that mutual agreement is going to be quite difficult. I think it was Mr. Matsuura, who was one of the chief negotiators prior to the meeting between Prime Minister Hosokawa and President Clinton, said it is fundamentally a matter of trust. He says, "You don't trust us without numbers and we don't trust you with numbers." But the truth is, there is an element of distrust and our wrong expectations of each other's behavior, I think, contribute to that.

So the hard task, the very, very hard task, is trying to find mutual areas that are in both of our interests, not only in bilateral trade but in trade within Asia, where there is a good deal of Japanese involvement. And I personally would like to see more involvement.

If you are a saver of Confederate money, it might—and you saved your LDP liberal Democratic dollars, I think they may be back. I think political apathy is a ripe opportunity for a political party that is well organized to take advantage of that. The

Shinshinto (New Frontier Party) is united in its hate for the LDP. All the factions within those different groups are not as united as the LDP.

As was mentioned earlier, LDP factions may have gone away. I think they have gone away in name only. Behavior is still far behind.

I think that the idea of exercising American moral authority is one way to influence behavior of our foreign partners. However, the moral foundation of our behavior has to be the same. And in Japan, you have very relativistic behavior versus our principle-based behavior.

I am not going to make a judgment which is better or right but they may not be swayed by our moral authority, and if we have to wait for U.S. moral authority, then I am sure you will be having these hearings for generations to come.

Thank you very much.

[The prepared statement of Dr. Farrell appears in the appendix.]

Mr. BEREUTER. Thank you very much, Dr. Farrell.

Thanks to all of you for your testimony.

Now we would like an opportunity to ask you questions.

And I would say to my colleagues, I think we have plenty of time, since there are only three of us here, to focus our questions on these witnesses. And what I am going to suggest we do is take 5 minutes each and then we will have a second round, as necessary, or a third round, so that we make sure that we all have that opportunity.

I would like to begin by focusing first on the economy. I would like to ask any of you who would care to address the question to what extent you think Japan's prolonged recession and current crisis among its financial institutions—or one or the other—has anything to do with the three successive unstable coalition governments we have had?

Are they related? Are they affected? Are they entirely independent of the political instability we have had at the top?

Dr. Feldman.

Dr. FELDMAN. Thank you.

In my mind, one of the wonders to me is that the Japanese fiscal and monetary policy have been as effective as they have, despite the political upheavals of the last several years. Even as the old LDP was falling apart during the late Miyazawa administration, they managed to come up with some very stimulative policies.

Under the Hosokawa Government, they came up with some very large tax cuts, the first time that they ever came up with a major tax cut as a stimulative policy in Japan. And now under the Murayama Government, despite its many difficulties, they have come up with yet another very, very large fiscal stimulus policy.

There has been a lot of activity by the Bank of Japan cutting interest rates. Had the Japanese authorities not taken these actions, we would not have had zero growth for the last 4 years. It would have been significantly negative.

The point I would like to make, though, is that what they have done is the easy stuff. It is easy to spend money. It is easy to cut taxes.

What they have not done is taken some of the difficult decisions on deregulation. I am not sure that the political disruptions have either slowed or hastened the deregulation agenda. Had the Hosokawa Government survived somewhat longer, perhaps they would have been a little bit faster. But the key thing in my mind is for the constituents, the voters, to say clearly what they want, and they have only had one opportunity in a general election to do so this July, an opportunity in the Upper House election.

I thought the message there was reasonably, although not overwhelmingly clear, that they do favor more deregulation. So I wouldn't say that this political disruption has been a major cause of the recession. It hasn't made it a whole lot worse, but it hasn't created the political competition to put deregulation on the right track.

Mr. BEREUTER. I would simply ask if there is any contrary view or any differing view on this subject?

Dr. FARRELL. I would basically say that the political instability is a result of, one, the end of the cold war, two, generational problems within the LDP and some severe leadership problems. At the same time, you have the economic disruption and that makes it worse for the Japanese people, but I don't think one is the cause of the other.

Mr. BEREUTER. All right.

Would any of you like to estimate whether or not Japanese industry will be more or less competitive relative to the United States after the economic shake-out?

Dr. FARRELL. I would say, more.

Mr. BEREUTER. Dr. Farrell.

Dr. FARRELL. I would say that they would be more competitive because they have learned to survive under some very difficult conditions. There are a whole series of bankruptcies taking place in Japan. There are a lot of small companies that are going under. But a lot of this has to do with speculation for a period of years prior to this, as well as the fact that they are not competitive. And so you are seeing some very difficult economic times, but I don't think that the prognosis is bad. The prognosis over another year or so, if not now, in certain industries you have more competition that's stronger.

Mr. BEREUTER. Dr. Janow.

Dr. JANOW. Let me just add a footnote on that.

I think that there are some parts of the economy that are adjusting and that will come out of this period of adjustment competitive. They are retaining their competitiveness. They will remain so. But if I had to choose between competitive U.S. industries and competitive Japanese industries, right now we are doing a whole lot better in almost every area where we compete directly.

But it is not the case that the Japanese economy is going downhill from here on. It certainly isn't. It is likely to experience lower growth rates than it has historically until now, and that's important. Their industries will remain globally competitive but ours are looking awfully good across a number of industries that even 5, 7 years ago we were deeply worried about.

Mr. BEREUTER. Dr. Janow, I would like to start a new round of questioning with you and let anyone chime in on the answer.

Do you think that Japanese manufacturing subsidiaries in Southeast Asia are simply transferring part of the U.S. trade deficit with Japan to a trade deficit with those countries?

Dr. JANOW. Japanese exports to Asia now exceed Japanese exports to the United States and have since about 1991. So there is a deliberate attempt, I think, to diversify their markets, and increasingly toward Asia, and imports from Asia now exceed imports from the United States.

Mr. BEREUTER. Is this true both ways now?

Dr. JANOW. It is true both ways.

Mr. BEREUTER. I think Dr. Farrell said yet that only 7 percent of their manufacturing sector is abroad—did I hear you say that?

Dr. FARRELL. Yes. My understanding is it is about 7 percent.

Mr. BEREUTER. Ours is about 22 percent but spread out perhaps more across the world, where theirs is more, perhaps, concentrated?

Dr. FARRELL. Well, they are certainly moving into Asia a great deal. And, you know, in global competition, we have to throw in the Koreans and Europeans, et cetera. There is competition that the Japanese face, not just from a more efficient United States, but from other partners.

But the trade is moving toward Asia. It is not at the detriment to the United States, but it is an economic reality. There is a great deal of growth there. It is a lot closer for Japanese to fly to Korea or to Taiwan or to Singapore, and the lines are better for communication there. So I think this is just a natural outcome.

And if we continue to buy Japanese air conditioners that are manufactured in Malaysia, it depends on where you want to put the red ink, but it is where we buy the product.

Mr. BEREUTER. Thank you.

My time has expired. I will come back for another round.

I would like to turn to Mr. Manzullo.

Mr. MANZULLO. Thank you very much.

I really enjoy the four of you giving this series of talks here about the bureaucracy that's stifling growth in Japan. I just wonder if our counterparts in Japan have a panel asking about the growth in America, whether or not it is being impeded by excessive regulations here in the United States.

I don't expect an answer on it. It is just one of those academic things that most of you academicians perhaps at another time could perhaps answer that question.

There was a recent TV news story on the auto show in Tokyo. The focus of the story was on developing American auto dealerships in Japan. I have a series of questions and I will just throw it out and let you work with these.

First of all, how successful do you feel the efforts will be to open those dealerships in Japan? Do you think we will be able to see more American cars and trucks, such as the Chrysler Neon, which is made in the district I represent, sold in Japan?

Do you think the Japanese are more or less amenable to buying American vehicles as a result of the Clinton administration's auto talks effort? In other words, is the success of more American automobile sales due to U.S. industry's self-initiatives or to U.S. Government negotiation efforts, or a combination of both?

Interesting four-part question.

Any takers?

Dr. Schoppa?

Dr. SCHOPPA. I think I would have to put the weight on the initiatives by the American industry. By targeting certain industries, though, the U.S. Government signals American firms with a commitment to back up these industries and therefore encourages American industry to make its own initiatives.

I think we can give the Clinton administration some credit for the recent push by the American automobile makers to invest in distribution networks there. But I think that in the long run, their own investments are going to be much more important than these self-declared targets that are part of the Framework Accords on autos.

The different American automakers have used several different approaches. GM has been inclined to work through Japanese distributors, while Chrysler now, and before that Ford, had shown much more willingness to invest their own money in building their own distribution network. Looking at that pattern and comparing it with other industries as well, that have tried to get into the Japanese market, I think that the ones that invest in their own distribution networks are going to be more successful and the Japanese market requires a long-term commitment, heavy investment of funds, before it is going to start yielding fruit.

Dr. FELDMAN. On that, I think one of the main reasons for the increased market share of U.S. autos in Japan—and you see a number of U.S. cars quite frequently in Japan just walking around Tokyo. You see a lot more U.S. nameplates. One of the reasons for that is that the dealers need products to sell and this is one sense in which the recession in Japan has actually worked to the benefit of deregulation.

One of the old theories about gaiatsu is that people are willing to put up with the costs of these corporate groups, of dealing only with certain people, of giving up competition in turn for some insurance. You know, when things turn bad, then they will be helped along.

But you are willing to buy insurance only at a certain price, and as the recession gets longer and longer, the auto dealerships in this particular case needed products to sell. So they were out there eager to have cars cheap enough for people to buy.

It is very similar to what happened in the U.S. auto dealership industry in the 1950's and 1960's here. Remember, you used to have Ford, GM and Chrysler dealers, and all of a sudden, it turned into Ford, Isuzu, Peugeot, and Renault in one dealership. That sort of change is due to pure economic pressure happening in the Japanese auto distributor industry today.

So I would put a lot of emphasis on the recession as an aid in changing the economic tradeoffs in whether to maintain or destroy gaiatsu relationships.

Dr. JANOW. May I add just a footnote:

The one feature where I think government attention was particularly necessary was on the regulatory features of the after-service-parts market. That wasn't going to be self-corrected by the reces-

sion, in my view. So it was very important that attention be focused on reducing some of those regulations.

Dr. FARRELL. My feeling is that it was a combination of economic factors. It made good economic sense to sell certain American cars. You know, one of the things of 1990 through 1992 or 1993, when I was there, all foreign cars only had 4 percent of the market, I mean, that was Volvo, Mercedes, Renault, etc.

The Japanese would always tell us why can't you be more like the Germans, because they had captured a whole 1.8 percent of the market. But at that time, 65 percent of the Mercedes sold had the steering wheels on the "wrong side".

The Japanese were buying foreign cars as status symbols, and Mercedes did very well because there was no Lexus and there was no Infinity or equivalent for a long time in the Japanese auto industry. So the whole auto industry is a very, very complicated factor and has a lot more to do with where you place the steering wheel.

I think it has a lot to do with economic factors. And what Merit mentioned about the after-parts industry is very, very important. That was a government-induced effort to make changes that were very, very critical, and economic forces weren't going to do that.

Dr. FELDMAN. If I can just add a couple little footnotes on that.

One other thing that our auto analyst in Tokyo emphasized is that the increased share of U.S. autos in Japan is also due to safety. That is, the safety regulations that are required of U.S. cars are sought by Japanese consumers. So they are safe, and that's one big selling point.

The second one is the yen. You know, with the yen at 100, it is a lot cheaper to buy U.S. cars than it was when the yen was at 140 or 160, and that does make a difference, especially in a recession.

Mr. BEREUTER. Mr. Chabot.

Mr. CHABOT. Thank you, Mr. Chairman.

I would first like to compliment the Chairman on pulling together such an excellent panel as we have had here this afternoon. I think the testimony has been very, very good and I want to compliment the folks here today for this testimony.

We just passed a historic reconciliation bill just this past week in which we balanced the budget over a 7-year period of time, and my question is: How do the Japanese view our efforts to get our fiscal house in order here in the United States, and what, if any, implications are there on trade?

And in addition to that—anybody that wants to handle these questions—also there has been talk about some at least temporary disruption in the financial markets as Congress and the White House deal with each other over the upcoming months and how—where we end up in this historic time to balance the budget.

My view is that that is just temporary and that any risk of error to the markets is much less than the risk that this country has if we continue to let our debt skyrocket and spiral. But I am just wondering, how do the Japanese view all of this and what are the implications on trade between our countries?

Anybody that would like to handle it.

Dr. Feldman?

Dr. FELDMAN. A person from our Washington office was recently in Tokyo doing a tour and he had back-to-back meetings, you know, from breakfast through dinner every day for the whole week he was out there. He gave the best-attended seminar that I have ever seen in our Tokyo office, so I can feel very confident in saying that the Japanese interest in this issue is extremely high.

One of the reasons they are concerned, just like investors in the United States, is that if there is any sign of some kind of default or something that smells like it or some kind of fancy dancing that the Treasury has to go through to avoid a default, then that is going to raise the cost of debt to the United States and it is going to lower the value of their securities. They are very concerned about that.

I think perhaps people in the United States in general are not aware of how much it is going to raise everybody's costs if some kind of train wreck like that occurs. So I think it is quite clear that the Japanese are just as sensitive as U.S. financial markets to that. And despite their lower holdings of Treasury securities over the last several years, they are still very important and they certainly have shown a great deal of interest in it.

Another point on this is the question of moral authority that I raised earlier. I think that if the United States does show some serious steps toward moving on the budget, and not only doing what we have done so far, but actually implementing it, clearly over the years—and remember, this bill is back-loaded in terms of the actual deficit reduction, and people are going to watch to see if it actually happens—but if we indeed follow the course that we have laid out in this reconciliation bill, that is going to have a moral authority effect on Japan, just as the U.S. deficit cuts in the 1993 bill, the one that passed 50 to 49, but did pass. That bill had some effect of encouraging the Japanese to get a little moving on their agenda, the deregulation agenda.

This is an issue that I consider one of the key things in the economic sphere in the moral authority area. The fact that we have taken these steps now is very key in getting the Japanese to take action on what they need to do.

Mr. CHABOT. Thank you.

If any of the other panelists would like to handle that, and if you could also specifically address the issue of, do you see the risk greater if—you know, for the economy and our relations in trade, et cetera, with the other countries if we caved in, basically, and didn't balance the budget, didn't do the things which we have said we are going to do?

Dr. Schoppa.

Dr. SCHOPPA. I agree very much with Dr. Feldman that the Japanese value very highly these moves toward serious deficit reduction in the United States. I think they wished that it happened a couple of years earlier, maybe 10 years earlier.

Dr. FELDMAN. That's right.

Dr. SCHOPPA. During the structural impediments initiative talks, we actually had a negotiating framework where we were supposed to trade off an agreement to move toward balancing our budget with their agreement to stimulate their economy with public investment spending.

Dr. FELDMAN. And deregulate.

Dr. SCHOPPA. And deregulate. And they felt that they followed through with their end of the deal in 1990, 1991, 1992, doing a lot of public investment and were disappointed that in the latter years of the Bush administration there was not serious attention to this promise that they felt they had had, to move toward deficit reduction. And after that, the Americans lost a lot of credibility or moral authority on negotiating with the Japanese about fiscal policy.

I agree with Dr. Feldman, that if the Americans continue to move toward a balanced budget, that in the G-7 Summits, or wherever the macro issues are negotiated in the future, the Americans will have more credibility.

Dr. FARRELL. Can I just make one comment?

Mr. CHABOT. Yes.

Dr. FARRELL. I am not sure a balanced budget is as critical as a much better deficit-to-capital ratio, because in our gross domestic product, gross national product, the percentage is not all that great. But we need to get as close to balance as we can, not for trade with Japan or for Japan's respect, but because it is for us and it is something that we need in this country.

That said, the Japanese do respect strength and it becomes very difficult to tell the Japanese what they should or shouldn't do when you can't get your own house in order, whether you call that moral authority or common sense. And then people talk about the fact that we have a debtor nation (the United States) providing military defense. You know, there are all kinds of scenarios that you can get off into here, but it is good for America to have a sound economy and that should be our primary motive.

Mr. CHABOT. Thank you, Mr. Chairman.

Mr. BEREUTER. Thank you.

I would like to build on Mr. Chabot's questions about deficits.

In the past, Japanese analysts and indeed some American analysts, particularly those that wanted Congress to be more conciliatory on trade issues, have suggested that the primary driving factor for our trade deficit was the American budget deficit.

I am wondering, in a relative sense, how important is this macro-economic answer to our trade deficits with Japan? I would like you to give me your opinions on that issue.

Dr. Feldman.

Dr. FELDMAN. I think it is tremendously important, but I would add that reducing the Federal call on domestic savings is only part of the issue. We have a private savings rate in this country that is much lower than the savings rates of most other industrial countries, and until we can get some changes in some of the distortions that we face in, say, our housing market—maybe we need some deregulation there, some changes in the tax system—until we get our private savings rate up, then we will continue to face deficits in our trade account.

Now, certainly, bringing the public sector under control is a tremendous step forward and a very difficult one, but getting some of the private savings issues addressed is also quite key into defending the dollar.

Mr. BEREUTER. Thank you.

Is there anyone here that feels that it is a factor, but that our budget deficits have been an exaggerated factor in explaining our trade deficits?

All right. Dr. Schoppa, I would like to start with you. I am sorry. Did I miss something?

Dr. Janow.

Dr. JANOW. I don't know how to quantify with any confidence what the impact of sectorial barriers are in terms of the bilateral deficit. Some academics have tried to come up with aggregate numbers for effects on the Japanese economy. These are controversial. I couldn't give you a number. But it certainly seems to me that we could get rid of the savings investment imbalance and still have real problems of market access. So the problem comes when we try and have our trade policies remedy our macro policy. That doesn't work. But you can't ignore the trade policy, either.

Mr. BEREUTER. Thank you.

Dr. Schoppa, I would like to start with you as a political scientist here. Do you want to make an estimate about when the next Diet elections will be held?

Dr. SCHOPPA. Well, the conventional wisdom that Dr. Feldman gave you, I would tend to agree with, that the most likely date is after the budget has been acted on in the spring, around March or April when the budget is acted on, then there will be most likely serious thought given to an election and that would mean the election would take place around May or so.

Mr. BEREUTER. If we are that far away from an election or that close, depending on your view, do you think that our current difficulties relating to the rape incident in Okinawa, or to a larger issue, the Status of Forces Agreement, will have an impact upon national elections?

Dr. SCHOPPA. I don't know if it is a matter of time as much as this issue being separated from partisan politics. I don't see either of the parties particularly trying to get a lot of play out of this issue, and, therefore, I don't think it is going to be much of a factor in a general election.

Mr. BEREUTER. Dr. Farrell.

Dr. FARRELL. The rape incident, like French nuclear testing, is convenient, because it really doesn't involve domestic politics. It doesn't impact on the budget, political reform, deregulation or anything, and you have somebody or something to point to outside. So from a domestic politics point of view, it is great. To have something that you can go after and still gain popular support by it.

The Finance Minister can go off and do parades in the south seas, et cetera, but I don't think it is going to have that important a reaction. A lot of this is domestic politics between Okinawa and Tokyo and share of the budget.

Okinawa is an economic runt as far as trickle-down money is concerned and they have a lot of issues with Tokyo, some of which deal with the bases. And so there is a lot more to this between Governor Ota and the central government than a GI's behavior in Okinawa.

Mr. BEREUTER. Dr. Janow.

Dr. JANOW. I was going to perhaps broaden it to the underlying question, which is how do candidates divide on management of

U.S.-Japan relations? At bottom, the ability to effectively manage U.S. relations is important for every major political figure in Japan today. So while this incident is producing much debate, I don't see candidates using it as a way of criticizing the U.S.-Japan security arrangement in a fundamental way. In fact, I think they are trying to keep it fairly narrowly focused.

Mr. BEREUTER. It has been one of the Clinton administration's views, widely accepted here in Congress, supported by this Member of Congress, that we ought not to reduce our military forces, our number of personnel, in the Pacific Region. And it seems to me this has been used as an effort to sustain the current basing and distribution of personnel within Japan. And I believe that has been, in fact, contrary to our military's advice. Our military has suggested we might properly—this is before the Okinawa incident—move personnel from Okinawa to other parts of the Pacific or to one of the mainland islands.

Do you have any reactions about whether that would be well received, significant or insignificant, in influencing Japanese public policy? Let's just say we are redistributing personnel within Japan.

Dr. FELDMAN. If I can just comment. I am not an expert on the military, but from reading the papers in Japan, when I saw Secretary Perry, I think it was quoted in the Japanese paper saying, "Well, look, we have been planning to take troops out of Okinawa and put them elsewhere in Japan anyway," that to me was seen as a sign of flexibility on the part of the United States to try to accommodate and come to an agreement that better meets the sort of psychological state of the Japanese feelings about U.S.-Japan relations right now. So I actually think that that was quite constructive in what it did for our relations.

Mr. BEREUTER. I did, too.

I will call on my colleague now, from Illinois.

Mr. MANZULLO. It is a real joy having the four of you there, and I want to join in Mr. Chabot's praise of the Chair in bringing you here. The district I represent is obviously involved in heavy manufacture but there is also a growing area and that is in agriculture.

Our agricultural exports to Japan are exploding. Hormel has a plant in the district I represent, and just in the past, I believe, several months, there is a new market over there. They are now shipping 20 tons of pork tenderloins and pork products per week to Japan.

And I would like your observations as to this new, excuse the pun, appetite for American food products, the long-range effect on it is this—you know, obviously, I don't think in terms of numbers it could ever, "overcome the other's scientific expertise in cellular phones and automobiles," but I would just like your general observation as to why—why this has taken place. What's the dynamic with American products being imported into Japan?

Dr. Farrell.

Dr. FARRELL. First of all, there has been some deregulation over the years bringing meat and citrus and other things in. There was a great deal of howling at the time in Japan.

Farmers were going to go out of business. The citrus farmers were going to be out of business. Once that was done and an adjustment over a period of a year or two, and Japanese trading

houses actually bringing in the beef and Japanese realizing they could eat it and not die. Frankly, there were all kinds of horror stories that came out of the Ministry of Agriculture, et cetera, about foreign foods. But now they have a choice—and from that point of view, you have Japanese farmers in this country or ranchers in this country selling product back to Japan.

You have those farmers also in Australia—a lot of beef coming in from Australia. That's part of consumer choice which goes back to my differentiation between a customer and a consumer. The Japanese consumer when given a choice will buy a foreign product. But part of that process was extensive and some long-term negotiations.

Dr. FELDMAN. I would like to identify what I think are six factors behind this. First is, Dr. Farrell mentioned deregulation. It has been very important.

Second, is change in the distribution system.

Dr. FELDMAN. In the Japanese economy overall, distributors are gaining power relative to manufacturers.

I was at, for example, a small food manufacturing company the other day. They were saying that some of the chain stores, the tiny little convenience stores, are so good at their inventory control right now that they will bring products in or cancel their orders overall within a couple day's time, because they know exactly what is selling at any one particular time.

So the needs of the distribution network and their improvements in inventory control have been very important in changing the balance of power, and if these distributors can get a better deal in terms of shipments and delivery from foreigners, well then, so be it, it is being done.

For example, the Japanese are now engulfed in a number of joint ventures to import beer, not only from Michigan but also from Australia. Maybe it says something about the exchange rate, another important thing, that the Japanese are carrying bubbly water halfway across the globe because it is cheaper to do that than to produce the beer locally, when the only natural resource Japan has is water.

Mr. MANZULLO. They import glacier ice.

Dr. FELDMAN. Yes.

Mr. MANZULLO. We don't have any of that in Illinois, unfortunately.

Dr. FELDMAN. Is there a representative from Alaska here?

Mr. MANZULLO. Next ice age.

Go ahead.

Dr. FELDMAN. In addition, demography is very important. The average age of a Japanese farmer right now is 59 or 60 years old. It is going up every year. Young people are just not going into farming. So 5, 10 years down the road, there is just not going to be food supply there.

All this talk about food security is the reason that we need rice controls. At least in my mind, it is nonsense, because, you know, my son is 7 years old now. If he decides to stay in Japan, in 15, 20 years from now, who is going to grow the rice for him? It is going to be more likely coming from California or Australia than it is from Japan. So demography is very important.

Exchange rates are extremely important, especially in the context of a recession, when people don't have the income as much as they used to have; they are looking for the cheapest stuff to buy. If foreign food is cheaper, then they will buy it.

Also technology, especially packaging technology, the fact that we can now package and keep things fresh for longer times, very important for our ability to survive. You mentioned high-tech products like semiconductors and automobiles. Well, food packaging and food production is also very high tech, so I would think our technological advantage in some of those areas is quite important.

Dr. FARRELL. The one comment I made about eat foreign food and not die goes back to, I think, reason four or five. There is a lot of social pressure, and sometimes from loosely termed "consumer groups" who do not want foreign foods in. Also you will find that at school cafeterias and in some of the social studies classes in schools—and my wife taught in one of them—teachers were saying, "Be careful, especially about this foreign rice; you don't want to bring any of that in; make sure it is good Japanese rice," et cetera. There was concern for all the impurities, and there were great stories about rice from Thailand and "all these dead rats being found". I mean this is great news. But there is this perception oftentimes of things foreign.

I also believe that the Japanese use more chemicals per square meter on their agricultural products than we do in this country. So it is kind of interesting. But it is from the outside, i.e. not Japanese, you have to be careful. Plus, everybody knows who has farmers in their State that that can be a very strong domestic constituency that you don't necessarily want to alienate.

Dr. SCHOPPA. The witnesses have mentioned everything but U.S. trade policy, and I think we have to give that some credit, not just this Administration but going back to the 1970's.

The Government has targeted the Japanese agricultural market in the various GATT rounds, the Tokyo Round, and then in the Uruguay Round. Many of the tariffs came down on a lot of these products, including, I believe, the pork that you referred to was a beneficiary of the latest round of tariff reduction, and when you quantify the benefits of American trade policy, the biggest have been in these agricultural markets. Beef, oranges, cigarettes, together account for a couple of billion dollars, I think, of extra American exports to the Japanese because of lowered, removed quotas, tariffication, lower tariffs.

Mr. MANZULLO. Thank you.

Mr. BEREUTER. Dr. Schoppa, I give my constituent Clayton Yeutter the largest single share of credit for that.

Mr. Chabot.

Mr. CHABOT. Thank you.

The question I have relates to what Mr. Manzullo just asked about farm products. I offered a bill early last week. It was cosponsored by a Democratic colleague of mine, Major Owens, whose district is in New York City. Our bill essentially, within 1 year of passage of the bill, eliminates all farm subsidies, price supports; we no longer pay farmers not to grow crops, all these programs that we have had since the Depression basically.

Now to be quite frank, I don't know that we have a tremendous chance of that passing, but what it does do, I think, is it takes the debate much further in the direction of at least phasing out price supports and agricultural subsidies and all those things in this country.

Chairman Pat Roberts on the Agriculture Committee has a proposal, and in fact in our reconciliation bill, at least in the House, that is in there at this point, phasing out.

What impact with our farm product, trade back and forth with Japan, could this have? Would they be likely to follow suit if we did phase out or eliminate the high cost of our food, much of which is related to the artificial support programs that we have in this country?

Yes, Professor.

Dr. SCHOPPA. You are asking whether they might voluntarily lower their agricultural barriers further if we negotiated such a thing, perhaps?

But I don't think you can expect the Japanese to follow our example on lowering their formal trade barriers. Even though I just recounted these billions of dollars of benefits, these were all hard-won negotiating concessions, and despite the demographic changes, the politics are still such that the Japanese Government is not going to quickly liberalize agricultural markets on its own.

The point I intended to make earlier, it is appropriate again now, though, is that the American Government has an opportunity to change this politics a little. When it puts pressure on agricultural markets in particular, the politics are very conducive to helping bring about change in Japan, because this is an area with many inefficient markets on the Japanese side. The demographics are also working this way, so that there are bureaucrats in different parts of Tokyo, probably even within the Ministry of Agriculture, who recognize that they need to make their farm sector more efficient, and so they are willing, when the American pressure is strong enough, to use that to push policy in that direction.

Mr. CHABOT. Dr. Janow.

Dr. JANOW. I commend you on this initiative, but it is important to keep agricultural trade in perspective.

Japan is a major importer of agricultural products. It does have remaining tariff peaks and has agreed to tariffication and phased liberalization in sectors that are politically difficult, like rice. Japan's agricultural sector employs a very small but powerful fraction of its population, and Japan is a major food importer. So I don't think that you are going to see much unilateral change in Japan's agricultural policies because the areas that are protected are protected because of very strong political influences. You might find more receptivity even in Europe than you will in Japan.

Mr. CHABOT. Dr. Farrell.

Dr. FARRELL. If I may, at one of the meetings, the Prime Minister has a special advisory group on deregulation, at which there are representatives from the private sector, and the American Chamber of Commerce has a representative there, the head of this particular women's Japanese group—I think it is "Shufuren" is the term—of wives, housewives. She recommended that the Japanese consumer be educated to pay higher prices for rice to protect the

farm industry, as opposed to deregulate it. This is a consumer's group, but you can see that the advocacy is somewhat different.

Mr. CHABOT. Yes. OK. Thank you very much. I will yield back the balance of my time.

Mr. BEREUTER. I thank the gentleman.

It is my view that strengthening the role of the individual Japanese Diet Member, and the Japanese Diet as an institution, is in the best interest of the Japanese people and the best interest of Japan-U.S. relations.

What can be done to strengthen the role of the Diet and the individual role of elected officials, including Diet Members, vis-a-vis the bureaucracy? I am asking what we can do—what is likely to be done in Japan? I think it is unlikely, for the most part, that we would have a role. We can have parliamentary assistance, efforts in trading information, exchanges, and so on, but mostly this has to be an internal process.

Dr. Feldman.

Dr. FELDMAN. In a talk with a senior politician a couple of weeks ago, he said to me, after a long discussion in front of a committee similar to this, that the key thing for politicians going forward was, in his words, to brandish the sword against the bureaucrats.

In order to do that, I think what they need are essentially two things: Information, that is, analytical capability such as Professor Schoppa mentioned earlier; but also some sense of guts and leadership. Heretofore they have been able to win elections without making policy proposals, without truly being leaders.

Under the new election system—and I understand that there is disagreement about this—I believe that the necessity of winning first past the post elections in individual districts will force politicians to focus on exactly what they stand for in public, and that is the sort of system that will encourage this kind of independence and forthrightness.

So I think they have taken one step; that is, getting the electoral system toward a more policy-oriented area; but I don't think they have taken the step yet of having, what I would say, competition between bureaucracies.

We have a competition between the congressional bureaucracy and the administrative bureaucracy here, and that actually generates—despite the inherent waste involved in it, it does generate a lot of debate about what should be done, and I think Dr. Schoppa's point about encouraging that in Japan is probably a very valid one.

Mr. BEREUTER. Individual members and the committees have almost no staff in the Diet. There are party committee staff that are not insignificant.

Dr. FELDMAN. But even those require a great deal of bureaucratic support.

Mr. BEREUTER. And they have mixed loyalties.

Dr. FELDMAN. Yes, indeed.

Mr. BEREUTER. Dr. Schoppa.

Dr. SCHOPPA. I think one of the few things—I don't think there is much—that the American Government can do to strengthen Japanese politicians, I am not absolutely sure that that is the key to solving the problem—

Mr. BEREUTER. Let me make it clear, I don't either. I think it is an internal matter, that they will have to figure out how to do it.

Dr. SCHOPPA. I guess it is a particular kind of politician that it is in our interest to strengthen, the political entrepreneur who might see an opportunity in catering to a larger group of Japanese consumers or a group interested in deregulation rather than those that focus just on narrow constituencies served by regulations.

One of the few things that we can do, I think, is use the bully pulpit that the American Government has in Japan. Just witness the attendance at this committee hearing. The Japanese media pays incredible attention to what the American Government says, and this gives the opportunity to future Administrations or the current Administration, if it undertakes a trade initiative that really seeks to play to the interests in Japan that would benefit from deregulation and trade liberalization, it has the opportunity to focus media attention on that as well and to build up the ground on which some political entrepreneur of that type might stand.

Mr. BEREUTER. Thank you.

Dr. Janow.

Dr. JANOW. There are Japanese politicians who are saying that things should change along these lines, and that they should have more political appointees in bureaucracies, and they should have more policy expertise in their staff. So that sentiment, I think, is now being widely discussed among politicians. So I think there is a considerable interest in creating more of a basis for differentiating themselves with other politicians, if nothing else.

It is not clear to me that the legal reforms that have occurred will naturally result in more policy emphasis, but I think there is more competition in other ways, and some rather specific proposals are now floating around.

Mr. BEREUTER. Dr. Farrell.

Dr. FARRELL. I think this information deficit that the Diet Members have impacts the ability of elected officials to be popularly elected and seen as such.

Right now, the Japanese Prime Minister is pretty much chosen by people within a party; he is not a popularly elected Prime Minister. So the whole concept of the Diet is not seen as that effective an organ of government. If it can compete effectively with the bureaucracy, then I think you have enhanced strength for the politician and therefore maybe enhanced strength to the Prime Minister who represents the Nation.

So it may be some lessons learned, some congressional history from the end of World War II to modern times, and reaction against the Roosevelt era, and too much executive strength, and the incremental changes that this institution has made to better formulate policy vis-a-vis the executive branch could be very instructive.

So from that point of view, not necessarily telling them how to do what they have to choose for themselves, but showing what Americans did, and use that maybe as a vehicle of debate, is this model valuable for Japan?

Mr. BEREUTER. With my colleague's indulgence, I have one other area of questions to pursue. I am not sure if you feel comfortable

responding in this area, but at least one of you may, and that is the subject of banking issues.

The Banking Committee, where I serve under the chairmanship of Jim Leach, has held hearings on this earlier. I am wondering to what extent you think the current banking problems in Japan are having an effect upon the Japanese economy or the economy of Southeast Asia, for example.

And second, what do you think of the performance of the Ministry of Finance in regulating institutions and, for that matter, informing U.S. regulators about the problem with the Daiwa Bank in New York City?

Does anybody feel comfortable responding to this? I thought maybe Dr. Feldman might.

Dr. FELDMAN. I can respond to the first one. I am not an expert on the regulatory issues, so I don't have much to say on the second one.

My clients ask me this question all the time, and the answer I give them is that I think that there is probably a great deal of effect that runs from the economy to the banking sector but not so much from the banking sector back to the economy.

It is clear that a recessionary economy hurts loan growth, hurts the ability of banks to charge wider spreads, earn their way out of problem loans, so that linkage is not under scrutiny.

But if you look at some of the evidence on whether the banking sector has actually caused a credit crunch in Japan—and that is the mechanism that this would work through—the evidence is not very clear on that, for a couple reasons.

The evidence itself: We have indeed seen virtually flat, somewhat negative, and now again slightly positive growth of bank lending, OK; so that is one piece that might suggest there is some kind of a credit crunch going on.

But if you look at the aggregate statistics on total borrowing by corporations, you see that growth is actually not particularly weak relative to nominal GNP growth, and the reason for this is that lending through the public sector, through the fiscal investment and loan program, et cetera, has picked up the slack from the private sector.

Now, is that a good thing long-term? Probably not, because it means something of a semi-nationalization of the intermediation mechanism and it also means that the competitive conditions in the banking system are an object for, shall we say, interference or initiatives by the public sector. That is to say, the money has to go through the budget before it can get back into the economy. It is not just a loan officer at the bank branch, but you have got to go up to the Diet, you have got to get an appropriation, etc. etc. So in that sense I think that there are some long-term problems, but it doesn't really show up in the aggregate lending figures.

The other minor critical piece of evidence is that if there were a credit crunch, real interest rates should be going up, but they are not, they are going down. So in that sense, I do not think that the banking crisis has particularly constrained the macro economy.

There was a paper recently done at the Federal Reserve on this issue, and they found a little bit of evidence on either side. Their conclusion was that there was a modest, very modest, effect from

the banking sector back to the real economy but much, much smaller than some of the other major factors that have caused the recession.

Mr. BEREUTER. Thank you very much. Thank you.

Dr. Farrell.

Dr. FARRELL. One of your colleagues, a couple of years ago, when the ACCJ visited from Tokyo for part of our efforts to educate the U.S. Congress, was a strong advocate of deregulation. He felt that if you deregulate the Japanese economy, you will get government out of business. You may deregulate the Japanese economy, but that doesn't get government out of business.

If you look, there are a lot of former senior Ministry of Finance people who are working in the banking industry and other industries related to finance. You have a relationship that develops that may be very personal. Therefore the desire to go ahead and blow whistles on friends, et cetera, I think would be dampened.

So as long as you have this close relationship, I think, between industry and government, regulations aside, you wind up having people who may be more concerned about protecting their friends or their former company. This is contrary, I think, to clear, transparent systems, and I think this needs to be explored, not only just the Daiwa case, but in how the Japanese and other countries regulate their financial industry.

Mr. BEREUTER. Thank you.

I turn finally to my colleague if he has any last questions. Mr. Manzullo.

Mr. MANZULLO. No.

Mr. BEREUTER. All right. I want to thank the panel very much for their outstanding testimony. I thought, in fact, the dialog we have had and the question-and-answer period was very important—I know this member benefited from it. I think that the information we generated here should ripple out across the American society and probably do a bit to improve Japanese and American understanding of our important relationship and what is happening in Japan.

Thank you so much for participating, for giving us your time. We appreciate it very much.

The hearing is adjourned.

[Whereupon, at 3:57 p.m., the subcommittees were adjourned.]

APPENDIX

HEARING ON US-JAPAN RELATIONS AND AMERICAN INTERESTS

*Opening Statement
Rep. Howard L. Berman*

October 25, 1995

Mr. Chairman, I congratulate you on holding another timely hearing on a critical issue. Demonstrations now raging in Okinawa against the American military presence and the intense debate in Japan on negotiations over a new Status of Forces Agreement (SOFA) covering American troops in Japan suggests that the state of US-Japan relations is not static.

I had the opportunity to be in Japan in late August where I met with several policymakers and strategic thinkers. I was struck then by their thoughtful discussion on ways to expand the boundaries of Japan's defense and foreign policies through force modernization and new forward roles in UN peacekeeping and expanded foreign aid. Japan has the resources not only to follow but also to lead the international community if it has the will.

At the same time, people were expressing concerns over the American role in Asia, including the extensive host-nation support for US forces, now accounting for 10% of Japan's defense budget. There was a willingness to call into question American commitment and strategy for Asia.

It was apparent to me, as well, that major changes in Japan are possible. Despite assurances given me by some last August that the Japanese people support the status quo, there was obvious enthusiasm for political and economic change. The Japanese people are demanding a more responsive political system. One person characterized it as now "dysfunctional."

Where this leads us is unclear. Japanese resurgence is coming at a time of American retrenchment while China is emerging as a major power. In addition the Southeast Asian states, South Korea, and Taiwan, are playing with more confidence in the international arena.

I look forward to today's testimony providing additional enlightenment on these issues.

U.S. DEPARTMENT OF STATE
Office of the Spokesman

For Immediate Release

April 23, 1993

WINSTON LORD
ASSISTANT SECRETARY OF STATE
FOR EAST ASIAN AND PACIFIC AFFAIRS

Winston Lord was sworn in as Assistant Secretary of State for East Asian and Pacific Affairs on April 23, 1993. He was announced for this position by then President-elect Clinton and Secretary of State-designate Christopher on January 19 and confirmed by the Senate on April 21, 1993.

Before assuming his duties as Assistant Secretary of State, Ambassador Lord had been chairman of the National Endowment for Democracy, vice-chairman of the International Rescue Committee, and chairman of the Carnegie Endowment for International Peace's National Commission on America and the New World.

Ambassador Lord's history of government service with the Department of State includes his appointment as U.S. Ambassador to China from 1985-89. From 1973 to 1977, he was Director of the Policy Planning Staff. Ambassador Lord was a Foreign Service Officer from 1961-67, during which time he was assigned in Washington to the Congressional relations, political-military and economic affairs staffs and abroad in Geneva. He has also served in the U.S. Government outside the Department of State as Special Assistant to the National Security Advisor (1970-73), on the National Security Council staff (1969-70), and on the Policy Planning staff in International Security Affairs at the Defense Department (1967-69).

From 1977 to 1985, Ambassador Lord was president of the Council on Foreign Relations. He also has been a member of the Asia Society, the American Academy of Diplomacy, the America-China Society, and the Aspen Institute of Distinguished Fellows.

Among the awards Ambassador Lord has received are the State Department's Distinguished Honor Award and the Defense Department's Outstanding Performance Award.

After graduating magna cum laude from Yale University in 1959, Ambassador Lord obtained an M.A. at the Fletcher School of Law and Diplomacy in 1960. He has received Honorary Doctorate degrees from Williams College, Tufts University, Dominican College, and Bryant College.

Ambassador Lord was born in New York City on August 14, 1937. His mother, Mary Pillsbury Lord, served for eight years as United States Delegate to the United Nations and U.S. Representative to the U.N. Human Rights Commission. He is married to Bette Bao Lord, whom he met while they were both studying at the Fletcher School. They have a daughter and a son.

HOUSE INTERNATIONAL RELATIONS COMMITTEE
Asia Sub-Committee

Testimony by

ASSISTANT SECRETARY OF STATE
FOR EAST ASIAN AND PACIFIC AFFAIRS
WINSTON LORD

October 25, 1995

-1-

Mr. Chairman, Members of the Committee:

Thank you for inviting me here today to share with you views on the current state of the U.S.-Japan relationship and where it is going. This is an extremely important and timely topic. Our relations with Japan have been called our most important bilateral relationship, and this has not changed.

The United States' and Japan's interests are predominantly congruent, and I believe they will continue to be so in the years to come. The United States and Japan share an interest in global peace and security and are cooperating around the world to this end. Our diplomatic coordination is close and fruitful. Our agenda on global issues is broad and growing.

The United States-Japan alliance, based on the Treaty of Mutual Cooperation and Security, is essential to the defense of both countries. It is a central element of the United States' policy of forward deployment and contributes directly to security and prosperity throughout

the Asia-Pacific region. The U.S.-Japan defense relationship is key to the United States' presence and continuing influence in the Western Pacific and Asia. It is warmly welcomed by the countries of the region.

The United States and Japan, as enormous economic actors, share a responsibility for the well-being of the world economy. Our governments are in frequent contact on questions of global economic management. And they cooperate closely on the maintenance and nurturing of the international economic institutions, including the IMF, the World Bank and the World Trade Organization.

Naturally we also have some differences with Japan. In a relationship as large and active as ours, such differences, particularly on trade, arise. We have had success under the Framework for Economic Partnership and elsewhere in negotiating agreements that resolved about 20 sectoral and structural trade issues. Both countries must continue to address and resolve trade issues constructively as they arise so that these issues do not hamper the rich commerce and overall ties between the United States and Japan.

The United States and Japan have common values as well as interests. We share a commitment to the principles of freedom, democracy, and the promotion and protection of human rights and the rule of law, both at home and in our

relations with other countries. It is the vision of a world based on these principles that lies at the center of the excellent relations between our two nations.

Let me first comment briefly about conditions in Japan.

Domestic Political Developments

First, a word about political developments. Prime Minister Murayama's three-party coalition government has been in office since June 1994. Many Japanese initially viewed the coalition with skepticism, because its two principal partners--the conservative Liberal Democratic Party (LDP) and the Socialist Party (JSP)--had been bitter ideological rivals during much of the postwar period. But despite occasional setbacks--including a poorer-than-expected showing in the July 1995 Upper House election--the coalition has proved resilient.

In September, the Liberal Democratic Party elected Ryutaro Hashimoto, the Minister of International Trade and Industry (MITI), to a two-year term as party president. Mr. Hashimoto was subsequently appointed Deputy Prime Minister. He also retained his portfolio as Minister of International Trade and Industry.

The political opposition is dominated by the New Frontier Party (NFP), an amalgamation of several opposition parties and groups that was created in December

1994. This party fared well in the July 1995 Upper House election, but its representation in the Diet is still considerably smaller than that of the ruling coalition.

In December 1994, the Diet enacted several electoral reform measures that could have a profound impact on Japanese domestic politics. The new system, among other elements, establishes a combination of single-seat and proportional constituencies and will shift seats from overrepresented rural areas to urban centers. Whether the reforms will lead to more frequent alternation of administrations between competing political parties remains to be seen.

We anticipate that Japanese political parties and coalitions will continue to undergo realignment for several years, until the consequences of the new electoral system work themselves out. In nationwide local elections held this past April, voters rejected mainstream gubernatorial candidates in Tokyo and Osaka, reflecting growing unpredictability in domestic politics. Elections in the important Lower House of the Diet must be held no later than July, 1997, four years after the last election, but many observers speculate that they will be held sometime during the first several months of 1996.

Political realignment has, of course, affected the decision-making process in Japan, including on issues of

critical interest to the United States. However, we have no reason to expect change in Japan's basic policy of strong support for the U.S.-Japan strategic alliance and U.S.-Japan cooperation in general. Today, all political parties, except for the minor Japan Communist Party (JCP), pursue close ties with the United States and endorse the Treaty of Mutual Cooperation and Security.

Domestic Economic Situation

Japan's economy seems headed next year for a modest rebound following four years of its most serious economic downturn since World War II. After achieving one of the highest economic growth rates in the world during the 1970's and most of the 80's, the economy slowed starkly in the early 1990's. Plummeting stock and real estate prices marked the end of the "bubble economy" of the late 1980's. Real economic growth in 1994 was 0.5%, following a contraction of approximately 0.2% in 1993. Private economic analysts project growth in 1995 to be just under one percent. For the past four years the U.S. economy has grown faster than Japan's.

Inflation in Japan remained below 1.0% throughout 1994. Unemployment rose to a seven year high, and considerable hidden unemployment belies the official rate placed at 3.2% in August 1995. Japanese domestic demand has been weak. In the wake of the collapse of the "bubble economy," many firms have substantial

over-capacity, which has suppressed private investment. Although industrial production was off by 4.5 percent in 1993, it rose by nearly one percent in 1994.

In an effort to stimulate growth, Japanese monetary authorities have reduced official interest rates to historic lows (of 0.5 percent in October 1995) and the government has enacted a series of fiscal stimulus packages. The latest and largest package, approved September 20, included about \$140 billion in additional government spending and lending. These steps appear to be having an impact. Private forecasters expect GDP growth to be around 2 percent in 1996, as a result of the stimulus packages. The outlook beyond that is not clear.

One factor that could affect economic growth is the financial sector where banks continue to struggle with record bad loans. The government has responded to runs on some financial institutions in the past few months and is now in the process of formulating a comprehensive plan to address these problems.

Japan's economic slowdown has contributed to the size of its current account surplus, \$129 billion (2.8 percent of GDP) in 1994, down \$2 billion from 1993. As Japan's economy resumes growth over the next several years, its current account surplus is projected to decrease to less than \$120 billion in 1995 and to approximately \$90 billion in 1996 (less than 2 percent of GDP).

The Japanese Government's regulation of a substantial number of business sectors contributes to slow economic growth and to Japan's current account surplus. Many Japanese economic and business leaders have joined outsiders in calling for rapid deregulation. The government's five year deregulation plan announced in March 1995 was judged by both domestic and foreign experts to be weak and lacking a comprehensive view of the kind of deregulation necessary to make the Japanese economy more open to competition. This plan is being reviewed with changes to be announced in March 1996. We are suggesting improvements in a number of specific areas.

Though Japan faces challenges in deregulating and stimulating its economy, its economic fundamentals remain strong. It has a large reservoir of industrial and technical leadership, a well-educated and industrious work force, and high savings and investment rates. Japan's long-term economic prospects remain good.

Japan is a very central economic partner for the United States. We are hopeful that Japan will enjoy more rapid economic growth in 1996 and that with growth U.S. exports of goods and services to Japan will rise. In short, Japan is in a period of political change and it is grappling with economic problems that are not trivial. However, we expect US-Japan ties to remain strong.

Japanese institutions do respond to the views of the electorate, when these views are strongly held. The Japanese continue to support close relations and cooperation between the United States and Japan, but the reservoir of goodwill is not something which we can take for granted. It needs to be nurtured, lest it dwindle.

Security Situation

Assistant Secretary Nye will address the security aspects of the U.S.-Japan relationship in some detail, so I will be brief here. However, I want to emphasize one point: the U.S.-Japan strategic alliance, based on the Treaty of Mutual Cooperation and Security, is the key to continuing U.S. influence in East Asia. Let there be no doubt: in this period of rapid change in East Asia, our alliance contributes directly to the security and economic well-being of the American people. The presence of 47,000 U.S. military personnel in Japan, combined with the personnel aboard Seventh Fleet ships (home-ported in Japan), allow us to contribute to the maintenance of stability in the region, forestall regional arms competition, including nuclear arms, and exercise influence over the course of events. The U.S.-Japan security relationship underpins a strong diplomatic partnership, allowing us both to better manage our relations with other Asian countries, indeed the world.

A year ago we set out purposefully to conduct an intensive security dialogue with Japan. Our mutual goal has been to re-examine and reaffirm the rationale and goals of our alliance in this 50th anniversary year of the end of World War II. Assistant Secretary Nye and I, and our deputies, conducted a series of meetings which led to a first-ever meeting in New York on September 27 where Secretary Christopher and Secretary Perry met with their Japanese counterparts, Foreign Minister Kono and Minister of State for Defense Eto. They reaffirmed that our alliance is the critical factor for maintaining peace and stability in the Asia Pacific region. Both sides welcomed the signing of the Special Measures Agreement which allows for the continuation, with some improvements, of host nation cost-sharing programs for the next 5 years. Japanese direct financial support for U.S. Forces amounts to almost \$5 billion annually, or about 70% of the cost. This is more than that provided by any other ally. In fact, it is more than the amount provided by all other allies combined. It is less expensive for us to maintain forces in Japan than here at home.

This year-long security dialogue in which we have re-examined the basis of our alliance and charted a new course for the future, one guided by common interests and a renewed commitment to a balanced partnership, will culminate in the November Summit meeting in Japan.

Because the U.S.-Japan alliance is so important, not only to our two countries, but to the entire region, the recent incident in Okinawa is all the more deplorable. The rape of an Okinawan schoolgirl, allegedly by 3 U.S. servicemen who have been indicted, is heinous under any circumstances, and the President, Ambassador Mondale, Secretary Christopher and Secretary Perry have expressed their deep personal regret and shock. This criminal act of a few individuals has provoked an outcry from the Japanese public. Some politicians and editorialists have questioned elements of the Status of Forces Agreement and the social costs associated with the presence of U.S. forces in Japan. The U.S. government has pledged its cooperation with Japanese authorities to see that justice is done in this case, and to take steps to prevent the recurrence of any such incident. Both sides are also working to ensure that the mechanisms we have to deal with situations like this are fully and expeditiously utilized in the future. In this regard, the Joint Committee of U.S. and Japanese Government representatives is examining the criminal justice procedures used when members of the U.S. Forces are arrested on suspicion of crimes in Japan.

Diplomatic And Other Cooperation With Japan

The U.S. and Japan share a broad range of other vital interests: regional stability; promotion of political and economic freedoms; protection of human rights and

democratic institutions; free passage of goods and services; strengthening of the nonproliferation regime, and peaceful settlement of regional disagreements.

This abiding community of interests existed during the Cold War and continues today, a time of extremely rapid modernization throughout much of East Asia. Despite modernization and economic growth, the pattern of domestic change and international integration is extremely uneven in the region. Japan is our essential partner in promoting common interests and values, not just in Asia, but around the world. We coordinate closely on Asian regional problems -- the North Korean nuclear issue, the peace process in Cambodia, the ASEAN Regional Forum, other regional security fora, as well as on regional economic issues.

Let me highlight briefly those areas where joint U.S.-Japan diplomacy has been particularly successful, and then suggest how the U.S.-Japan diplomatic relationship might develop in the near future.

Japan has played a new, important and growing role in United Nations peacekeeping missions by contributing funds and personnel in Cambodia and Mozambique. It also participated in international efforts to provide humanitarian assistance to Rwandan refugees. Japan has recently indicated that it will send a contingent of

peacekeepers to the Golan Heights. We expect that it will continue a policy of measured participation in international peacekeeping. Japan's heightened profile in international peacekeeping strengthens its longstanding bid for a permanent seat on the UN Security Council, which we support.

This September, Prime Minister Murayama visited several nations in the Middle East where he discussed with the region's leaders Japan's role in the peace process. He indicated that Japan will continue to extend economic assistance to Syria, Palestine, and Jordan, and will seek to strengthen economic ties with Israel. We welcome Japan's participation in the peace process, and expect that it will continue to have a significant role.

Japan has joined or supported other U.S. diplomatic initiatives. Japan, along with the Republic of Korea, has been a central partner in our nuclear negotiation with North Korea, and will make a major contribution to programs designed to eliminate the North Korean nuclear threat and reduce tensions on the Korean peninsula. We have also engaged in positive dialogue about Japan's participation in the reconstruction of Bosnia. The Japanese have indicated a willingness to assist in such efforts. They have announced that once the parties fully reconcile Japan will open an embassy in Zagreb to coordinate its rehabilitation efforts in the former Yugoslavia.

An extraordinary, if somewhat unheralded, example of successful cooperation with Japan is the "Common Agenda," which we launched in July 1993 as part of our Framework Agreement in order to address jointly difficult long-term global problems. We are cooperating on a very broad agenda, including global health and population, the environment, and science and technology. In two short years, this enormously successful bilateral partnership has grown to encompass 20 different initiatives.

Among the many highlights, we are collaborating on one of the most successful public health initiatives ever undertaken -- a massive immunization program that has virtually eradicated polio in the Western Pacific and aims to wipe out the disease worldwide by the year 2000. We have worked together closely on population and HIV/AIDS programs with concrete results in countries such as Bangladesh, Kenya, the Philippines and Indonesia. We have also established an extensive and formal Environmental Policy Dialogue under the Common Agenda through which we seek to harmonize our approaches on critical global issues such as climate change, biodiversity and hazardous waste.

Last year we broadened our cooperation and joined efforts in countering the production and trade of narcotics. This year, we began the Women In Development initiative which focuses on enhancing girls' education and

will also include assistance in financing and services for women's micro-enterprises in developing countries. These many success stories may not attract headlines, but they provide an excellent vehicle for the U.S. and Japan -- as two economic superpowers -- to pool resources and set the pace in finding solutions to common global problems.

We will continue to consult and collaborate closely on a full range of regional and global matters in the future.

The U.S.-Japan Economic Relationship

The U.S.-Japan economic relationship is deep and multifaceted. Japan is our largest overseas export market, our largest supplier of imports and an important source of investment, technology, and profits for U.S. firms. However, significant imbalances continue to characterize our economic relations with Japan. Owing in part to structural features of its economy, Japan continues to have a large global current account surplus and a large current account surplus with the United States.

U.S. exports to Japan amounted to \$53.5 billion in 1994 and reached \$36.4 billion in the first seven months of this year. Yet there remain many impediments to Japan's market. These include concentration in some industries, the pattern of inter-corporate relationships in the various keiretsu, and intrusive government regulations in many industries. The statistics suggest

the extent of the problems. Japan's imports of manufactured goods as a percent of GDP were only 2.9% in 1994 as compared to 7.9% for the U.S. and 10 to 22% for other G-7 nations. U.S. and other foreign firms continue to encounter serious difficulties exporting to and investing in Japan.

The U.S. is committed to opening Japan's markets more fully and to ensuring that competitive foreign goods have fair access. We believe it is in Japan's interest to admit more foreign products and to give its consumers the opportunity to purchase goods based on quality and price. The United States has urged Japan to correct its persistent global current account surplus, to remove impediments to the Japanese market and to remove regulations, which hinder domestic and foreign businesses. This is not only in our interest. It is in Japan's interest as well as the health of the global economy.

During the past two years, the United States has pursued its economic goals with Japan through the Framework for Economic Partnership, which the two governments established in July 1993. Under the Framework we have made progress in resolving a variety of sectoral, structural, and macroeconomic issues. And in June in Halifax, President Clinton and Prime Minister Murayama extended the Framework agreement and renewed their

commitment to work together on remaining issues.

During the Clinton Administration, the U.S. and Japan have signed over 16 trade agreements, most of them under the Framework, plus four under the Uruguay Round. U.S. and Japanese negotiators concluded results-oriented agreements on flat glass in January, on financial services in February, on Investment in July and on autos and auto parts in August. Earlier we concluded agreements on government procurement, cellular phones, intellectual property rights, construction and various agricultural products, including apples.

Negotiations and agreements over the years have had concrete results. In the past decade Japanese imports from the United States have more than doubled. The portion of manufactured goods in our exports to Japan has steadily increased and now approaches two-thirds. Japan is the United States' largest foreign market for commercial aircraft and agricultural products. Despite such progress, much of course remains to be done. We will continue to highlight the urgency of further opening Japan's market.

One important task is monitoring implementation of our trade agreements to ensure that the Framework's goal of substantially increased access and sales of competitive foreign goods and services is realized. The

-17-

Administration and the private sector are working hard to see that all agreements are fully and vigorously implemented. We plan to continue to identify quickly any problems in implementation and move to resolve them.

Even as we address bilateral issues, we continue to work with Japan in APEC to build a "Pacific Community." Together we will be striving to ensure the November's leaders meeting in Osaka builds on the successes of Blake Island and Bogor and makes real progress toward trade liberalization in the Asia/Pacific region. Any effort in Osaka to weaken the commitment to comprehensive trade liberalization made by all APEC leaders last year in Bogor will be widely viewed as a step backward for APEC.

As might be expected in a trade relationship as large as that between the U.S. and Japan, there are a few issues on the horizon that have the potential to grow into disputes if we do not act to resolve them. Our hope and our challenge is to address these issues in a constructive manner that will ultimately benefit the U.S., Japan, and the world trading system. Our two nations must deal openly and directly on these problems.

Our approach from the outset of this Administration was to insulate security and other positive elements of the relationship from trade frictions. We did this not as a favor to Japan, but because it was in our interest to do

-18-

so. We also recognized that the unresolved issues, if allowed to fester, over time could erode domestic support for other elements of the partnership. That is why we have made such serious efforts to address our economic differences even as we have worked successfully to strengthen the other areas of our relationship. Our relationship with Japan rests on solid ground. But as recent events have illustrated, we must constantly nurture our ties and seek to mitigate problems. Ambassador Mondale characteristically put it well: no matter what problem confronts the world, it will be easier to resolve if the United States and Japan work together.

The President's Visit to Japan

The President will travel to Japan in November, to Osaka for APEC and to Tokyo for a state visit and a summit meeting with the Prime Minister. The preparations for the visit have included a thorough review of the extent of our interests and the scope of our cooperation with Japan. The United States and Japan have a very strong relationship of enormous benefit to both nations, the region, and the world. The President's visit provides an opportunity to make clear to Americans and Japanese alike that:

- The U.S.-Japan strategic alliance is fundamental to our mutual security and to stability and prosperity in the Asia-Pacific region.

-19-

- U.S.-Japan cooperation on diplomatic issues ranging from nuclear arms to Asian security to global peacekeeping, make the world a safer place.
- The two countries' cooperation on newer global issues like those under the Common Agenda promote the welfare of other countries and at the same time strengthen our bilateral relationship.
- We have made progress in resolving trade and other economic issues with Japan, and it is in our mutual interest, and that of the global economy, to carry this process forward.

The President's visit to Japan therefore comes at a very important juncture. Together our two countries have travelled an enormous distance in the past half century. Building on that solid record and recognizing the global implications of our bilateral ties, we will strive to bolster one of the world's most productive partnerships.

Thank you.



Joseph S. Nye, Jr.
Assistant Secretary of Defense
(International Security Affairs)

Joseph Nye has been Assistant Secretary of Defense for International Security Affairs since September 15, 1994.

From March 1993 to September 1994, Mr. Nye was Chairman of the National Intelligence Council, after serving as Director, Center for International Affairs, Dillon Professor of International Affairs, and Associate Dean of Arts and Sciences at Harvard University.

From 1977 to 1979, Mr. Nye served as Deputy to the Under Secretary of State for Security Assistance, Science and Technology and chaired the National Security Council Group on Nonproliferation of Nuclear Weapons. In recognition of his service, Secretary of State Cyrus Vance presented him the highest Department of State commendation, the Distinguished Honor Award.

Currently a Fellow of the American Academy of Arts and Sciences, Mr. Nye has also been a Senior Fellow of the Aspen Institute, a Director of the Aspen Strategy Group, and a member of the Executive Committee of the trilateral Commission. He has served as Director of the Institute for East-West Security Studies, a director of the International Institute for Strategic Studies, the American representative on the United Nations Advisory Committee on Disarmament Affairs, and member of the advisory committee of the Institute of International Economics.

A former member of the editorial boards of *Foreign Policy* and *International Security* magazines, he is the author of numerous books and more than a hundred articles in professional journals. His most recent books are *Bound to Lead: The Changing Nature of American Power* (1990) and *Understanding International Conflicts* (1993). In addition, he has published policy articles in *The New York Times*, *The Washington Post*, *The Atlantic*, and *The New Republic*. He has appeared on programs such as ABC's *Nightline* and *Good Morning America*, NBC's *Phil Donohue Show*, CBS's *Evening News*, and the McNeil-Lehrer Report, as well as Australian, British, French, and Swiss television.

Mr. Nye received his bachelor's degree from Princeton University in 1958. He did postgraduate work at Oxford University on a Rhodes Scholarship and earned a Ph.D. in political science from Harvard University.

In addition to teaching at Harvard, Mr. Nye also has taught for brief periods in Geneva, Ottawa and London. He has lived for extended periods in Europe, East Africa, and Central America.

**Statement of
Dr. Joseph S. Nye, Jr.
Assistant Secretary of Defense,
International Security Affairs**

**before
the House Committee on International
Relations
Subcommittee on Asia and the Pacific**

October 25, 1995

In November 1994, the Departments of Defense and State began an initiative to reaffirm our security relationship with Japan in the post-Cold War environment. In January of this year, I sat before this subcommittee and reported our intentions regarding the Asia and Pacific region. I identified the remarkable stability and economic growth in East Asia and the Pacific over the past 20 years as proof of the increasing importance of this region to the United States. And I described the long-standing American ties to the region, emphasizing the importance to the United States of continued development of these relationships.

The U. S.-Japan bilateral security relationship is extremely important to America's security. The security, political, and economic aspects of our bilateral relationship reflects fundamental interests shared by the U.S. and Japan -- to preserve the benefits of expanded trade and political progress which have exemplified East Asia during the last two decades. The U.S.-Japan bilateral security relationship is fundamental to both bilateral security and regional stability. It is also the basis for global U. S.-Japan cooperation.

We continue to believe that the bedrock of East Asian and Pacific stability has been -- and will continue to be -- the forward presence of American troops operating from U.S. bases. The U.S. military presence in Asia is anchored in the security relationship with Japan. The Secretary of Defense's *East Asia Strategy Report* emphasizes the strong American commitment to the Asia and Pacific region, and the intention of the U. S. to maintain its military presence at the current level of about 100,000 troops.

Over the past year, we have undertaken an intense bilateral dialogue with the Japanese government. The dialogue is based on bilateral, regional and global security cooperation with Japan, focusing on the U. S.'s commitment; Japan's contributions; regional stability; new Japanese missions such as PKO and BMD; the immediate challenge of North Korea; and the importance to regional and global stability of China's successful integration into the regional security system. While the security dialogue is an ongoing effort, the initiative we have undertaken during the past year is now focused on a Security Declaration, to be issued by the President and Prime Minister at the Tokyo bilateral summit this November.

The single most important U. S.-Japan bilateral security meeting of this Administration to date took place on 27 September in New York. Secretary Perry and Secretary Christopher met for a historic, first ever 4-way meeting with their counterparts from Japan, Foreign Minister Kono and Defense Minister Eto. This meeting of the Security Consultative Committee (SCC), referred to as the "2+2," was the culmination of the previous year's work, and the final milestone in preparation for the November Summit.

The meeting accomplished two significant goals. First, it provided the unique opportunity for the four cabinet-level officials to meet together and with their respective senior advisors and senior military officers, to reaffirm the bilateral relationship and the centrality of the security relationship. Second, Secretary Christopher and Foreign Minister Kono signed the Special Measures Agreement. Japan is our most generous ally in host nation support. The SMA will continue, for an additional five years, the Government of Japan's payment of appropriate yen based costs for U. S. force presence in Japan, part of the larger Host Nation Support arrangement. In addition to yen based costs, Host Nation Support includes Japan's contributions in areas of Facilities Improvement Program (FIP) and treaty obligation payments. In 1995, this amounted to more than 70% of our non-salary costs. Japan's JFY 1995 payments for Host Nation Support totals \$5 billion. Provided FIP and treaty obligation payments remain the same for the next five years, Japan's total host nation support payments for U. S. forces in Japan will total more than \$25 billion over the life of this Agreement.

In addition to the two goals of affirming the centrality of the security relationship and signing the SMA, the 2+2 meeting helped to prepare for Prime Minister Murayama and President Clinton's bilateral Summit meeting in November. Discussions with the Japanese Ministers covered the need to coordinate our security policies, and prospects for Japan's National Defense Program Outline, that nation's long range statement for security policy, which currently is being revised. We told the Japanese Government that one measure of success would be a clear overlap in approach between the NDPO and the DOD's *East Asia Strategy Report* published earlier this year.

The Subcommittee's invitation identified several areas of special interest. I will address each of these issues individually. You asked me to address:

- the U. S.-Japan relationship against a backdrop of a changing post-Cold War Asia-Pacific region;
- the status of U. S.-Japan relations;
- where we should strike the balance in our bilateral ties both among competing American policy objectives, and between our relations with Japan and other regional states;
- the China factor in U. S.-Japan security ties;
- host-nation support arrangements; and
- the impact of the recent rape incident in Okinawa.

U. S.-Japan relationship against a backdrop of a changing post-Cold War Asia-Pacific region

There is no more important bilateral relationship than the one we have with Japan. I justify this assertion based upon two premises. First, that

our economy is tied to that of Asia to such a degree that Asian stability and security equate to U.S. security. Second, that our military presence in Japan supports critical US global interests and helps us to fulfill global responsibilities. For these reasons, close security cooperation with Japan is indispensable.

U. S. interests are directly tied to Asian security because of our economic dependence upon the Asia and Pacific region. We engaged in \$373 billion in trans-Pacific trade in 1993. That is twice as much as in 1970, and the amount is growing. We expect trans-Pacific trade to be twice as much as trans-Atlantic trade by the year 2000. Today, about 3 million American jobs can be traced directly to exports across the Pacific, while many million more depend indirectly on Asian economic growth. U. S. exports to Japan alone totaled \$47 billion in fiscal year 1993.

The Japanese archipelago affords US forward deployed forces geostrategically crucial naval, air and ground bases on the periphery of the Asian land mass. Under the US-Japan Treaty of Mutual Cooperation and Security, Japan provides a stable, secure, and low-cost environment for our military operations and training. Despite the breakup of the Soviet Union and the ensuing decreased military threat to the region, our presence in Japan remains a vital aspect of our global forward deployed posture. US forces operating from bases in Japan are committed not only to the defense of Japan, but also to the preservation of peace and security in the entire Asian region, and are prepared to deal with a wide range of local and regional contingencies. Given the great distances associated with the Pacific theater, forces maintained in Japan fill the requirement for forces capable of dealing with regional contingencies.

The status of U. S.-Japan relations;

Increasingly, our military presence in Japan will be less the insurance policy it was during the Cold War and more of an investment for the future. Where American alliances used to provide insurance against a Soviet threat, our security commitment to Japan today provides the foundation for U. S. military presence in Asia. And these forces today serve as our investment in the continued security and stability of the region.

This relationship, we are pleased to say, receives broad and essentially universal support throughout the region, including long-term Japanese domestic support.

We agree with the vast majority of Asians, who understand that our bilateral security ties with Japan are one of the key factors supporting regional stability. Furthermore, the U.S.-Japan security relationship also underscores

key vital American security interests and remains fundamental to both our Pacific security policy and our global strategic objectives.

Where we should strike the balance in our bilateral ties both among competing American policy objectives, and between our relations with Japan and other regional states

Unlike Europe, Asia lacks a strong multilateral system of security guarantees. We will continue to depend primarily on our strong bilateral relationships with Japan and our other allies. Multilateral institutions may develop. In the meantime our investment in the region is most valuable. We rely on a robust partnership with Japan to advance our regional and global agenda at the UN, in global nonproliferation regimes, and in other multilateral fora.

Japan's global role is evolving toward greater contributions to regional and global stability. Japan is the world's largest Official Development Assistance provider and has increased its involvement in humanitarian and peacekeeping efforts around the globe, including Cambodia, Mozambique, and Zaire. The Government of Japan is considering sending a UN Disengagement Observer Force (UNDOF) team to the Golan Heights early next year.

Japan supports emerging democracies, particularly in Asia. Japan's continuing close cooperation with the United States in a strategic partnership is conducive to regional peace and stability and supports broad United States global objectives. Japan's new "National Defense Program Outline" will review national security objectives in light of changes in international security, based on the continuing importance of the Japan-United States security relationship.

The relationship gathers strength from the degree of shared perspectives between the U. S. and Japan. Specific examples include the North Korea issue and the problem of the proliferation of weapons of mass destruction, coordination on China, as well as other regional and global security and economic issues.

We have spent the last year in an intense security dialogue with the Government of Japan, designed to reaffirm our security ties. Our policy of reaffirmation does not come at the expense of national economic policies, but results from trends which necessitated renewed attention to the security leg of the bilateral relationship — questioning in both countries of the continued validity of long-standing relationships overtaken by the end of the Cold War; the demise of the Soviet threat; Japan's emergence as an economic superpower; bilateral trade friction without the salve of a common enemy;

and concern on both sides of the Pacific about American staying power and Japan's future orientation.

The China factor in U. S.-Japan security ties

The rapid growth in China's material strength has raised the importance of China in the Asian security equation, and our consultations in China with the GOJ are an essential part of our security and political dialogue with Tokyo. We believe that China's successful emergence as a responsible regional power and global actor is essential to our mutual security and regional stability.

China is a nuclear weapons state, a leading regional military power and a global power with a permanent seat on the UN Security Council. China's stability is essential for peace, stability, economic growth in the Asia-Pacific region, and friendly relations with its neighbors.

The United States, for its part, is enhancing its military dialogue with China in order to promote better mutual understanding, as well as greater transparency and trust. This dialogue is maintained through periodic high level visits, participation in professional fora, and functional exchanges. Through the newly established Defense Conversion Commission, we hope to facilitate cooperation between Chinese defense enterprises and American businesses in civilian production.

With reference to the role of the U. S.-Japan Alliance vis-a-vis China, the U. S. and Japan must engage China constructively to assure it is integrated into the regional security system. China must realize that the U. S.-Japan security dialogue is not an effort to constrain or ostracize China. Our bilateral relationship derives from our common interest in promoting economic growth and political stability in East Asia. These are ends which China supports. We are taking pains to ensure that Beijing understands this. In order to assure the continued economic prosperity of the region, China must be integrated into the international system in a way that respects its position as a regional power and ties its economic and political advancement to maintenance of amicable relations with its neighbors.

The impact of recent events in Okinawa

Finally, you asked me to comment on the deplorable rape of a young school girl in Okinawa, allegedly by three U. S. military personnel stationed on the island. The judicial process is well underway and the case will be resolved in due course.

The incident has, however, brought some long standing bilateral issues to the attention of the Japanese media. Certain elements within the Japanese polity are taking advantage of the situation to protest our presence, and in particular our bases in Okinawa. These issues include resolving the realignment and consolidation of some U. S. facilities in Okinawa and reviewing the Status of Forces Agreement (SOFA). Let me take this opportunity to emphasize that the U. S. Japan alliance is stable; it serves our mutual interests and is the bedrock of peace and political stability in the region. The position of the GOJ is clear on the presence of U.S. Forces in Japan. Our presence is mutually beneficial and the GOJ unequivocally support the continuation of the Alliance and continued U. S. military access to bases.

Some statements in the media and by some Japanese politicians have used this incident to call for a review of the SOFA and a pretext to halt further negotiations on the reversion of land issue. Our USIA polls indicate that this is a minority view and that the preponderance of the Japanese people supports the Alliance. We are reviewing procedures for the transfer of judicial custody of accused SOFA personnel to the GOJ. Tokyo agrees with us that SOFA revision is not necessary.

We will continue to cooperate with Japan on the outstanding security issues, including pursuit of the North East Asia Security and Cooperation Dialogue, supporting peacekeeping operations in the Middle East, and pursuing confidence and security building measures with North Korea.

We look forward to the bilateral Summit in Tokyo in November and continuing to work with our Japanese Allies in promoting peace and stability in East Asia. A key outcome of the Summit will be a Security Declaration issued by the President and Prime Minister. We have agreed in principle to the Declaration and are working out the details of language that will establish publicly the basis for continued strong bilateral security ties.

Ambassador Richard Lee Armitage

Richard L. Armitage, the President of Armitage Associates L.C., has held senior troubleshooting and negotiating positions in the Departments of State, Defense, and the Congress since 1978.

From March 1992 until his departure from public service in May 1993, Mr. Armitage directed U.S. Assistance to the new independent states of the former Soviet Union with the personal rank of Ambassador. In January 1992, the Bush Administration's desire to jump-start international assistance to the former superpower resulted in his appointment as Coordinator for Emergency Humanitarian Assistance to the former Soviet Union. During his tenure in these positions Mr. Armitage completed extensive international coordination projects with the European Community, Japan and other donor countries.

From 1989 through 1992 Mr. Armitage filled key diplomatic positions as Presidential Special Negotiator for the Philippines Base Agreement and Special Mediator for Water in the Middle East. President Bush sent him as a Special Emissary to the Middle East during the 1991 Gulf War.

In the Pentagon from June 1983 to May 1989, he served as Assistant Secretary of Defense for International Security Affairs. He represented the Department of Defense in developing politico-military relationships and initiatives throughout the world, spearheaded U.S. Pacific security policy including the U.S.-Japan security and U.S.-China relationships, managed all DoD Security Assistance programs (\$5-6 billion per year), and provided oversight of policies related to the law of the sea, U.S. special operations forces, and counter-terrorism. He played a leading role in Middle East Security policies.

In May 1975 Mr. Armitage came to Washington as a Pentagon consultant and was posted in Tehran, Iran until November 1976. Following two years in the private sector, he took the position as Administrative Assistant to Senator Robert Dole of Kansas in 1978. In the 1980 Reagan campaign Mr. Armitage was senior advisor to the Interim Foreign Policy Advisory Board, which prepared the President-Elect for major international policy issues confronting the new administration. From 1981 until June 1983 Mr. Armitage was Deputy Assistant Secretary of Defense for East Asia and Pacific Affairs in the Office of the Secretary of Defense.

Born in 1945, Mr. Armitage graduated in 1967 from the U.S. Naval Academy, where he was commissioned an Ensign in the U.S. Navy. He served on a destroyer stationed on the Vietnam gunline and subsequently completed three combat tours with the riverine/advisory forces in Vietnam. Fluent in Vietnamese, Mr. Armitage left active duty in 1973 and joined the U.S. Defense Attache Office, Saigon. Immediately prior to the fall of Saigon, he organized and led the removal of Vietnamese naval assets and personnel from the country.

Mr. Armitage's endeavors include past service on the Board of Directors of General Dynamics Electric Systems, Inc. and the Board of Visitors of the United States Naval Academy. Current positions include Chairman, Board of Visitors of the National Defense University, member of the SecNav Committee on Women in the Navy and Marine Corps and the Advisory Board of ManTech International Corporation. He recently chaired the Honor Review Committee for the United States Naval Academy. He has also advised the Secretary of Defense as a member of the Defense Policy Board. He has received numerous U.S. military decorations as well as decorations from the governments of Thailand, Republic of Korea, Bahrain, and Pakistan. Mr. Armitage has been awarded the Department of Defense Medal for Distinguished Public Service four times, the Presidential Citizens Medal, presented by the President to citizens who have performed exemplary deeds of service, and the Department of State Distinguished Honor Award.

Mr. Armitage lives in Vienna, Virginia, with his wife Laura, four daughters, two sons, and two foster sons.

Ambassador Richard L. Armitage
President, Armitage Associates
October 25, 1995
Committee on International Relations
Subcommittee on Asia and Pacific Affairs

Years ago when I was in the service, "KISS" was regarded as a useful acronym -- meaning, "Keep it Simple, Sailor." It may be no less valid when one is analyzing a broad foreign policy matter such as the future of the U.S.-Japan relationship. Others can speak in grandiloquent terms about the length and breadth of the social, economic and political relationships between the two countries. There is a great body of public information about our interwoven financial dependency. In previous testimony over the years, other panelists and I have sketched the history and successes of our mutual security relationship over the past 40 years. Therefore, I have but 3 or 4 items to place before the subcommittee today.

The Nye Initiative

Today, you have heard from Assistant Secretary of Defense Joseph Nye, and the subcommittee has heard for some time now about the "Nye Initiative with Japan." I fully and earnestly support this initiative. Moreover, in my view, Joe Nye and his able assistants, notably Commander Paul Giarra and Lieutenant Colonel Robin 'Sak' Sakoda, deserve full credit for bucking the tide of this Administration's foreign policy approach and shoring up the U.S. interest in this manner. Their activities reflect good policy, good sense and courage of convictions.

But it must be noted that what is today highlighted as the Nye Initiative and held up to be so noteworthy was, in previous years, simply regarded as good alliance management. In that regard, I believe that both the U.S. and Japanese governments have work to do in more fully informing their publics of the rationale for the alliance after the Cold War. Additionally, U.S.-Japan military roles and missions -- which were so effective in deterring the Soviet military in Asia in the 1980s, are in need of adjustment appropriate for the new strategic environment.

Asian Security Agenda

It is well understood in the U.S. foreign policy community that the future of the Korean peninsula is our most pressing problem. Sooner or later, in one fashion or another, this peninsula will be unified. Clearly, our presence in Japan will be very instrumental in that process. Whether reunification is by force, persuasion or a collapse, the U.S. military presence in Japan will be of key value.

Moreover, a post-unification Korean peninsula will present the northwest Pacific region with a host of delicate arms control problems. Because of historic animosities and neuralgia with which Asia-watchers are all too familiar, these issues can only be dealt with by an honest broker -- that is, by the United States. History as a guide has shown us that we would not feel confident in regional negotiations resolving these issues without our being physically present and willing to lead.

However, noting that Korea is our most pressing problem, China is indisputably our most important problem. Before much longer we will learn whether China will climb atop the world stage as a helpful, benign political force among nations or as an intrusive, brooding and, possibly, unstable presence.

At a minimum, over the next generation, China will increase its population by a minimum of 300-400 million. Already the country suffers from low acreage of arable land per capita, lower even than Bangladesh, and from an array of environmental problems perhaps second to none. China's growth is creating tremendous pressures for resources and energy, at the same time that its military is engaged in much needed, but worrisome nonetheless, modernization. We can already see a large transient population in China that will only grow with time. None of us can afford a sick, destabilized China, if only for fear of the transnational migration it would create and the pressures such a dislocation would bring to bear on friends and allies in the region from Australia to Korea.

While China increasingly dominates the focus of regional projections, let us not forget about Taiwan. In the past, it was one thing to deal with the delicate China-Taiwan policy issues when Taiwan was a martial-law state. By March of next year, however, Taiwan will have its first democratically-elected President, and that country's political democratic transformation will be complete. This is a new factor in our foreign policy outlook, one which, frankly, will only be highlighted if the political transition in Hong Kong once it reverts to China in 1997 is regressive. Without a significant presence and strong, stable U.S.-Japan relationship, it is difficult to imagine a steady and peaceful evolution in the Pacific.

In marked contrast to the rest of the world, defense spending is on the rise in the Pacific Rim. London's IISS estimates that military spending in East Asia rose 9% between 1992-1994 (after accounting for inflation). This year's growth will be 6%. The question, then, is not whether this trend will continue. The only questions have to do with offensive/defensive procurements and the preservation of the force in strategic terms. Although the rise in defense spending is seen, at present, as a result of strong economic growth, the trend bears close watching.

Finally, the evolution in the Russian Federation is far from complete. By observing the behavior of Moscow towards the "near abroad," we will be able to judge whether the changes there are cosmic or merely cosmetic. The jury is still out.

In sum, if the U.S.-Japan relationship is strong; the challenges I mentioned in Korea, in China and elsewhere in Pacific Asia can be met. If Washington and Tokyo do not remain solid partners, however, destabilizing forces in Pyongyang, Beijing and elsewhere may be provided unnecessary opportunities for mischief.

The bottom line for America's interests is as follows:

- All Americans, I believe, want the U.S. to be valued in Asia for our economic prowess, our societal vibrance, our multireligious, multiracial makeup, as well as our catalytic capability as an honest broker among other nations. We want to be seen as the pillar of democracy and a beacon of hope for the nations of Asia.
- But whether we like it or not, what makes us truly a factor in the region is our ability to sustain a military presence and project power. In this regard, let me add that I strongly support the concept of a 100,000-person ceiling in our East Asia strategy.
- In stressing our ability to sustain a military presence, let me remind the subcommittee that I was the negotiator who was obliged to tell our allies in the Philippines that their military bases were not so important to us in the wake of the cold war. I'm not enamored of presence for simply the sake of presence. The quantity of U.S. forces does not equate automatically to increased capabilities.
- The fact of the matter is that it is the quality of U.S. leadership combined with a competent military force that makes for national strength. Our relationship with Japan has served both parties well, and will continue to do so with dedicated and enlightened leadership on both sides of the Pacific.
- The national interests are self-evident. The competence of our forces is high. What remains to be achieved is a farsighted policy executed by purposeful leadership.

VANDERBILT UNIVERSITY

NASHVILLE, TENNESSEE 37212

TELEPHONE (615) 322-7311



*Institute for Public Policy Studies • 1207 18th Avenue South • Direct phone (615) 343-6980
Internet: Auerje@CTRVAX.Vanderbilt.edu
FAX (615) 343-6983*

Center for U.S.-Japan Studies
and Cooperation

James E. Auer, Ph.D.
Director

JAMES E. AUER is the Director of the Center for U.S.-Japan Studies and Cooperation at the Vanderbilt Institute for Public Policy Studies; Research Professor of Public Policy at the George Peabody College, Vanderbilt University; Adjunct Professor of Management at the Owen Graduate School of Management, Vanderbilt University; and Adjunct Professor of the Management of Technology at the Vanderbilt School of Engineering. From April 1979 until September 1988, he served as Special Assistant for Japan in the Office of the Secretary of Defense. He served in the U.S. Navy from 1963 to 1983 in a number of positions, largely in Japan. These included visiting student at the Japan Maritime Self-Defense Force Staff College (equivalent of the U.S. Navy War College) in Tokyo, and commanding officer of a guided missile frigate homeported in Yokosuka.

He holds an A.B. degree from Marquette University and a Ph.D. from the Fletcher School of Law and Diplomacy, Tufts University. His thesis, *The Postwar Rearmament of Japanese Maritime Forces 1945-1971*, was published in English by Praeger Publishers and in Japanese translation by the Jiji Press under the title *Yomigaeru Nippon Kaigun*.

STATEMENT OF JAMES E. AUER
DIRECTOR, CENTER FOR U.S.-JAPAN STUDIES AND COOPERATION
VANDERBILT INSTITUTE FOR PUBLIC POLICY STUDIES
VANDERBILT UNIVERSITY

BEFORE THE

SUBCOMMITTEE ON ASIA AND THE PACIFIC
COMMITTEE ON INTERNATIONAL RELATIONS
UNITED STATES HOUSE OF REPRESENTATIVES

REGARDING

U.S.-JAPAN RELATIONS AND AMERICAN INTERESTS IN ASIA:
STRIKING A NEW BALANCE

OCTOBER 25, 1995

Mr. Chairman, Members of the Subcommittee:

I am honored to be asked to present my views to the Subcommittee on the subject of U.S.-Japan Relations and American Interests in Asia: Striking a New Balance. I believe it is an extremely important subject and it is encouraging to know of the Subcommittee's interest in it.

Last week I attended a meeting here in Washington, D.C. during which a senior Defense Department official in a previous administration expressed his view that the U.S. and Japan don't really have an "alliance" even though there is a "security relationship." He said that true allies will "take off their jackets and fight for each other" and, although this may constitute the U.S.-Japan relationship in the future, it is not the past and current situation.

Although I understand that view and respect the gentleman who expressed it, I disagree. Had deterrence failed in the 1980s and had the U.S. and the Soviet Union clashed in the Northwest Pacific, it is my judgement that Japan would have engaged its significant anti-submarine and air defense assets to augment U.S. forces. I believe that Japan would have taken off its coat and fought alongside the U.S. because there was a high degree of trust between President Reagan and Prime Minister Nakasone, and because if Japan had refused to fight under those conditions, I don't think the U.S. would have allowed the continuation of the U.S.-Japan Security Treaty. Thus, in such a situation, I believe Japan would have supported the U.S. because to do so was in Japan's national interest.

U.S.-Japan defense relations have been much more positive than trade frictions obviously, and, in the 1980s Japan possessed a high technology air defense and anti-submarine network which complemented U.S. power and contributed meaningfully to negate any political benefits of Soviet military power in Pacific Asia. In the Persian Gulf War, however, Japan decided, unwisely in my opinion, not to contribute even token military forces to the U.S.-led coalition, leading some to believe, as my interlocutor last week suggested, that Japan is not a real U.S. ally.

Despite the fact that the U.S. and Japan, as the world's two leading economic powers, do have increasingly similar national interests in preserving both regional and global stability, Japan hesitated to send forces to the Persian Gulf because of the beliefs of some Japanese government leaders and of some elements in the public that Japan is legally prevented by its Constitution from sending military forces outside of Japan's local area. During the Cold War, Japan was located in close proximity to the central egress point of virtually all Soviet Pacific-oriented military power. Many, although not all, of the same people who believe Japan cannot operate abroad in areas such as the Persian Gulf, believe Japan can engage in military operations around Japan even if Japanese territory is not actually invaded.

Those in Japan who believe Japan cannot engage in collective self-defense and deploy forces outside Japan's local area are not exclusively members of the Social Democratic Party of Japan (SDPJ -- formerly Japan Socialist Party) and the Communist Party. Some members of

the long-ruling Liberal Democratic Party (LDP), which lost exclusive control of the Japanese Government in 1993 and which presently governs in coalition with the SDPJ, also feel Japan cannot engage in such actions. Unfortunately the relationship of trust between the top leadership of the U.S. and Japan is not as strong today as it was in the 1980s. If Japan firmly determines that it cannot participate in any scenario other than one in Japan's immediate vicinity, then I would agree that Japan cannot be a real ally of the U.S. now that the Cold War is over and the biggest threats to the U.S. and Japan may not just happen to be located in Japan's immediate proximity.

But others in the LDP, as well as many in the major opposition party, the "Shinshinto" (New Frontier Party), believe that while Japan is legally prohibited from conducting offensive operations, Japan has the legal right to engage in collective self-defense and send Japanese military forces abroad as a complement to U.S. forces as Japan did when it sent four minesweepers and two support ships to the Persian Gulf following Desert Storm. While these Japanese believe that Japan can thus "take off its coat" and be a worthy ally of the U.S. in a variety of post Cold War world scenarios within the present Constitution, some of them would like to remove the present ambiguity and clarify Japan's right to do so by amending Article 9 of the Constitution.

As does Ambassador Armitage, for whom I was honored to work during the Reagan Administration and with whom I am pleased to testify today, I strongly support the rationale and goals of the Pentagon's "United States Security Strategy for the East Asia and Pacific Region" signed by Secretary Perry and prepared under the auspices of Assistant Secretary Joseph Nye. I know that Secretary Nye has initiated an in-depth dialogue with Japanese officials about the importance of the U.S.-Japan security relationship, and I hope, owing at least partially to that effort, Japan will reach a consensus that it does indeed have the right to engage in the collective self-defense operations that will allow Japan, legally, by political decision, within the present Constitution, or via a revised and clarified Article 9, to join the U.S. as a real ally in the post Cold War world when it is in Japan's national interest to do so.

As Assistant Secretary Nye's report points out, the immediate security problem in Asia is the clear and present danger of North Korea. And while cautioning that the U.S. should "engage" rather than try to "contain" China, the report realistically notes it is in the U.S. interest to prevent the emergence of an Asian hegemon. I believe that Japan shares the same concerns as enumerated by Secretary Nye and supports the same or similar goals. And, most important, regardless of what happens in North Korea and in China in the future, if the economically and militarily strong U.S. and Japan remain closely linked in a true alliance relationship, neither North Korea nor China will be able to threaten Pacific stability in the economic center of the world.

Four of the five ships I served on as a naval officer from 1963 to 1983 were homeported in Japan. Whereas the Philippine Bases I frequently operated from were extremely convenient for supporting Southeast Asia operations, the U.S. bases in Japan are much more essential to

viable U.S. Western Pacific and Indian Ocean operations. During my naval career I operated frequently with Japan's highly professional Maritime Self-Defense Force. And in the unstable post Cold War world we live in today, I believe that joint U.S.-Japanese naval exercises to which other Asian navies - including those of China and Russia - might be invited to participate, have never been more important as a symbol of American and Japanese determination to prevent any disruption to stability in the Spratly Islands, in the Taiwan or Malacca Straits or in other strategic locations in the Pacific Basin.

Before closing, I want to add a word about the recent incident in Okinawa Prefecture, Japan in which a 12-year old girl was allegedly raped by three U.S. servicemen. I was in Japan from September 24 to October 6 and this incident was at or near the top of the news every day I was there. Many, if not all, Japanese in Okinawa and elsewhere are outraged by this action, and some are saying that if U.S. servicepersons are endangering the well-being of Japanese youth, what is the purpose of the alliance, especially after the Cold War. I could only tell the Japanese with whom I met that all the Americans I know are also outraged by this incident. As the father of an 11-year old daughter, I don't know how I could personally cope with such a tragedy. But while Japanese and Americans are outraged at what allegedly took place, every Japanese I met said that this aberration should not call into question the U.S.-Japan alliance which is fundamental to Japan's and the Asia-Pacific's well being.

In conclusion, Mr. Chairman, I believe, as I think Ambassador Armitage and Assistant Secretary Nye do, that maintaining a solid U.S.-Japan alliance is a wise, bipartisan U.S. policy which greatly contributes to peace and stability in the Asia-Pacific region during and after the Cold War. Particularly if Japan makes clear that it does have the right to participate in collective self-defense, I believe that Japan has the wherewithal to continue to be a worthy U.S. ally without acquiring offensive military capability or without becoming a military superpower.

Japan is the second largest economic power in the world; Japan still has the particularly capable anti-submarine, minesweeping and air defense forces which helped deter the Soviets in the 1980s; together, the U.S. and Japan, which constitute only about seven percent of the world's population, represent a robust 40 percent of global GNP. A solid U.S.-Japan stability force is, in my opinion, a wise insurance policy against instability and is, therefore, the best way to create an international environment in the Asia Pacific in which there is no way to settle disputes except through peaceful means.



THE NATIONAL BUREAU OF ASIAN RESEARCH

715 SAFECO PLAZA ■ SEATTLE, WA 98185 ■ (206) 632-7370 ■ FAX (206) 632-7487

KENNETH B. PYLE

Kenneth B. Pyle is Professor of History and Asian Studies at the University of Washington, where from 1978 to 1988 he was also Director of the Henry M. Jackson School of International Studies. He is President of The National Bureau of Asian Research. He is the author or editor of numerous books on modern Japan and its international relations including *The New Generation in Meiji Japan* (1969), *The Making of Modern Japan* (1978), *The Trade Crisis: How Will Japan Respond?* (1987), and most recently *The Japanese Question: Power and Purpose in a New Era* published in 1992 by the American Enterprise Institute.

Professor Pyle was founding editor of the *Journal of Japanese Studies* from 1974 to 1986. He is a member of the Board of Governors of the Henry M. Jackson Foundation (1983-) and the Maureen and Mike Mansfield Foundation (1981-88). In 1992, he was appointed by the Director of the U.S. Information Agency to be Chairman of the Japan-U.S. Friendship Commission, a Federal agency which administers a trust fund, established by Congress at the time of the reversion of Okinawa, to support Japanese studies in the United States and American studies in Japan. He is co-chairman of the official bilateral panel of the U.S. and Japanese governments, overseeing the educational and cultural relations of the two countries.

Professor Pyle is a graduate of Phillips Academy, Andover (1954), took his B.A. *magna cum laude* from Harvard College (1958), and his Ph.D. from Johns Hopkins (1965) where he was the Walter Hines Page Fellow in International Relations. He held a Ford Foundation Fellowship at the Interuniversity Center for Japanese Studies in Tokyo (1961-64). He has been a visiting faculty member at Stanford and at Yale. He is a member of the Council on Foreign Relations in New York and a member of the Advisory Board of the Japan Foundation.

TESTIMONY OF
KENNETH B. PYLE

PRESIDENT, THE NATIONAL BUREAU OF ASIAN RESEARCH
PROFESSOR OF ASIAN STUDIES, UNIVERSITY OF WASHINGTON

OCTOBER 25, 1995

HOUSE COMMITTEE ON INTERNATIONAL RELATIONS
SUBCOMMITTEE ON ASIA AND THE PACIFIC

I would like to thank Chairman Bereuter for inviting me to testify before the House International Relations Subcommittee on Asia and the Pacific on the subject of U.S.-Japan relations. For the record I would like to submit a copy of my essay on U.S.-Japan relations which I recently wrote for *America, Japan, and APEC: The Challenge of Leadership in the Asia-Pacific* which will be published next month by the National Bureau of Asian Research.

In reviewing the present state of our relations with Japan I believe there are five factors that should be borne in mind.

My first point is a point drawn from history. After every great war in the last two centuries the victorious nations have always taken the lead in shaping the new institutions, values, and principles that will govern international relations in the postwar era. Following World War I and World War II it was the Americans who created the new institutions and rules to establish an order in the Pacific. We have not yet done that in the post-Cold War era. There are reasons for this lack of initiative: the sudden, unexpected end of the Cold War, the absence of an immediate threat to peace, and our present preoccupation with long deferred domestic problems. Moreover, in Asia several Cold War issues are still with us: we still have communist states in China and North Korea; we still have the Cold War division of Korea, the Taiwan problem, the Kurile Islands dispute. Nonetheless, it is our place to provide the leadership for a new order. No other country can lead in the region. The most significant new institution is APEC and it was devised by an Australian prime minister whose initial intention was to exclude the United States. Moreover, APEC's shortcomings are many: it is narrowly economic, it has a tiny \$2 million budget, no infrastructure, no decision-making or dispute resolution procedures.

My second point is that the U.S.-Japan relationship is the most critical aspect of the future Asia-Pacific order because it links the dominant economic power of Japan with the dominant military power of the United States. But in the post-Cold War era this relationship is beset by contradictions and anomalies. It will be difficult to sustain it indefinitely in its present form. A half century after the end of World War II we continue to maintain 46,000 troops in Japan and to provide a unilateral security guarantee for the Japanese state at a time when we are running a \$60 billion trade deficit with Japan--if we include exports from Japanese firms in Southeast Asia to the United States the deficit is well over \$80 billion. Why is the world's largest debtor nation providing the security for the world's largest creditor nation when many Americans regard Japan's economic power as a greater threat than any other country's? The short answer is that the United States and many other Asia-Pacific countries do not trust Japan to rearm responsibly. Many Japanese including the present prime minister agree. So we have the anomaly of Japan paying another country to prevent its own rearmament. As one Japanese politician put it, "we Japanese are paying the jailer to keep us in jail." Of course, Japanese bases do serve the American national interest also and since Japan is paying 75 percent of the bill, it is argued that it is a good bargain. In the long run, however, the mercenary role does not suit either the American national character, nor does this dependency role square with Japan's national traditions.

My third point is that new realities in the region also make a reappraisal of our relations with Japan essential. What are the important new features of post-Cold War Asia-Pacific? When World War II ended and the Cold War began only one Asian state, Japan, had industrialized. Today we have a large number of industrial, and increasingly prosperous states which have a vital stake in the new order and which should share the burden of its maintenance. There is an enormously enhanced economic interdependence in the region and that ensures that the economic component of national security calculations will be magnified. In addition the age of nationalism has dawned in Asia. Today these former colonies are self-confident, self-assertive, independent states, often critical of the West. In the past ten years Japan has achieved a massive economic expansion into Asia. This Japanese presence in Asia is not necessarily congruent with American economic interests. Japan has adopted what I would call an international industrial policy. It is quite similar to the industrial policy that Japan used to develop its internal economy and which has made it so difficult for us to crack the Japanese market. It involves close business-government cooperation and the coordinated use of private investment, official aid, and trade in order to help Japanese multinationals build vertically integrated production networks throughout Asia. This move to off-shore production is the result of the strong yen and allows Japan to export to the U.S. market without further inflating the trade deficit. Because of these pervasive production alliances throughout Asia, Japan does not need to worry about protectionism in other Asian countries. The Japanese approach to APEC is therefore different from ours and is much more sympathetic to the Asian approach of resisting U.S. efforts to press for rule-based free trade practice.

My fourth point is that because maintenance of the security alliance with the United States is critical to Japan's economic strategy, vital to its foreign policy, and essential to its domestic political system, we should expect a greater degree of reciprocity and burden sharing. Across the board, virtually all sectors of the Japanese political spectrum support the treaty. After opposing it for more than forty years throughout the Cold War, the Socialist party this year came around to support it. It reassures the rest of Asia that Japan will not be a military threat and therefore provides a cover for the Japanese economic strategy in Asia. It avoids the disruption and divisiveness in domestic politics that would inevitably occur if Japan were forced to revise its constitution and establish an independent military. It is hard to understate the trauma this would create. Finally, the many Japanese leaders that I have interviewed are increasingly concerned about China and its uncertain political-military-strategic intentions in the future. Japan looks to the Americans to assume responsibility for containing Chinese military power.

My fifth point is that because in the post-Cold War era security is no longer simply strategic and territorial but is now much more economic, we must look at the *whole* U.S.-Japan relationship. Many believe that we should keep the security aspects of the alliance separate from the economic issues that are the source of so much friction. We should not, they say, link economics and security because trade friction might jeopardize our security structure. But, I believe, we can no longer separate out economics and security in Asia. They are indivisible.

What then are our options regarding the alliance? Where do we strike a balance? *Broadly speaking* I think there are three options:

1.) We can continue the alliance in its present form indefinitely as the new Defense Department report on security strategy for the East Asia-Pacific region envisions, maintaining our present bases and troop levels. Japan will be kept a "global civilian power." This will leave the United States overwhelmingly responsible for maintaining security for an economically thriving and prosperous regional economy dominated by Japan. It will require us to seek continually increased host nation support from Japan, which already pays 75 percent of the costs of keeping U.S. bases and forces in Japan. The United States will have to accept a role akin to mercenaries. This peculiar arrangement is necessary because Japan is not trusted to have its own defense. Although the Japanese are pleased to have the bases serve their national interest at this stage, the day is likely to arrive when an increasingly assertive Japan will reject the anomaly of financing foreign bases that are there in large part to "contain" Japan.

2.) A second broad option would be for the United States to adopt a classic balance of power approach to East Asian security. Former Secretary of State Kissinger has observed that "the relations of the principal Asian nations to each other bear most of the attributes of the European balance-of-power system of the nineteenth century. Any significant increase in strength by one of them is almost certain to evoke an offsetting maneuver by the others. The wild card is the attitude of the United States, which has the capacity--though not necessarily the philosophy--to function in much the same way that Great Britain did in maintaining the European balance of power until the two world wars of the twentieth century. The stability of the Asia-Pacific region, the underpinning of its vaunted prosperity, is not a law of nature but the consequence of an equilibrium which will need increasingly careful and deliberate tending in the post-Cold War world." The drawback of such an approach is that while it would help resolve many of the contradictions and anomalies of our present policies it would compel Japan to embark on a rapid independent rearmament. The prospect of growing Chinese strategic influence, and a potentially unified Korea, would likely stir Japan to exercise the nuclear option.

3.) A third broad option is the establishment of a new U.S.-Japan equilibrium, a comprehensive revision of the alliance based on clearly defined new purposes, a more equal and reciprocal alliance with a rationale attuned to the new realities of post-Cold War Asia. We must recognize that for the first time in modern history Japan has become a status quo country with as great a stake in the stability of the international system as any country. It must carry a much greater burden of preserving stability in the system. A revised alliance should clearly link economic and security considerations and include a commitment to achieving the following four goals. First of all, there must be a harmonization of economic institutions so that the rules of the game in trade and competition are acceptable to both countries. Secondly, there must be closer cooperation on official aid projects. Two-thirds of Japanese aid is allocated to Asia and largely targeted for strategic commercial purpose. The alliance can be made more reciprocal by

forging closer cooperation on aid and funneling it through multilateral institutions. Third, a reciprocal alliance should entail sharing of dual-use technology. Fourth, a revitalized alliance must be predicated on Japan's playing an enhanced role in collective security. Eventually, such a revised U.S.-Japan alliance might serve as the core of an organization of Pacific nations, an integrated security community formed at U.S. initiative which would be less exclusively dependent on U.S. resources. In this way, the goal of preventing an independent Japanese military would be achieved through positive measures, rather than through the present relationship which is increasingly out of step with the new conditions in the region. By articulating a coherent new vision and mission for the alliance we can ensure the support that will be required both at home and in the region to sustain and strengthen it in the post-Cold War era.



ANALYSIS

Volume 6, No. 3

AMERICA, JAPAN, AND APEC: THE CHALLENGE OF LEADERSHIP IN THE ASIA-PACIFIC

AMERICA, APEC, AND THE ROAD NOT TAKEN: INTERNATIONAL LEADERSHIP IN THE POST-COLD WAR INTERREGNUM IN THE ASIA-PACIFIC	<i>Donald C. Hellmann</i>	5
JAPAN'S PERSPECTIVE ON APEC: COMMUNITY OR ASSOCIATION?	<i>Akio Watanabe and Tsutomu Kikuchi</i>	23
THE CONTEXT OF APEC: U.S.-JAPAN RELATIONS	<i>Kenneth B. Pyle</i>	37

APEC Study Center at the University of Washington
The National Bureau of Asian Research

© 1995 by The National Bureau of Asian Research.

ISSN 1052-164X

Printed in the United States of America.

The National Bureau of Asian Research, a nonprofit, nonpartisan institution, conducts advanced policy research on contemporary and future issues concerning East Asia, Russia, and U.S. relations with the Asia-Pacific region. NBR does not advocate policy positions, but rather is dedicated to providing expert information and analysis for effective and far-sighted policy decisions.

The *NBR Analysis*, which is published five times annually, offers timely reports on countries, events, and issues from recognized experts. The views expressed in these essays are those of the authors, and do not necessarily reflect the views of other NBR research associates or institutions that support NBR.

This report may be reproduced for personal use. Otherwise, its articles may not be reproduced in full without the written permission of NBR. When information from this report is cited or quoted, please cite the author and The National Bureau of Asian Research.

Funding for this publication was provided by the Henry M. Jackson Foundation.

Publishing and production services by Laing Communications Inc., Redmond, Washington.

NBR is a tax-exempt, nonprofit corporation under I.R.C. Sec. 501(c)(3), qualified to receive tax-exempt contributions.

This is the twenty-third *NBR Analysis*.

For further information about NBR, call or write:

THE NATIONAL BUREAU OF ASIAN RESEARCH

715 SAFECO Plaza
Seattle, WA 98185
Tel: (206) 632-7370
Fax: (206) 632-7487
E-mail: nbr@cuix.pscu.com

THE CONTEXT OF APEC: U.S.-JAPAN RELATIONS

Kenneth B. Pyle

The search for a new order in the Pacific is proceeding as though it were heeding an old Spanish proverb. "Traveler," says the proverb, "there are no roads. Roads are made by walking." Asia-Pacific Economic Cooperation (APEC), the most important effort to find a way to a new order, is a forum for discussing trading and financial relationships and principles in the region. It is an initial effort, a groping, for some kind of regional economic organization. Former Japanese Prime Minister Tsutomu Hata approvingly described this approach as "creeping incremental gradualism by consensus." The justifications for this tentative, experimental, approach to the formation of a regional organization are familiar: in the Asia-Pacific region, unlike Europe, there is no historical basis for an international state system; there have been few multilateral organizations in the region; there is too much diversity; there are no common cultural traditions; Asians prefer an organic approach rather than an *a priori* rules-based approach.

These justifications for a slow, evolutionary approach easily become an excuse for failing to grapple with the new dynamics that will govern the region's international relations in the early part of the coming century. Most notable is the failure to deal with great power relations and with the security dimensions of the new order. Will there be a continuation of bilateral alliances between a still-preponderant American superpower and individual Asian states? Will there be a balance-of-power system among China, Japan, the United States, and other countries? How will the dynamics of economic and military power relate? Will there be, in addition to APEC, a regional security organization? How will the region's power relations fit into a larger global system of international relations? In short, what will be the forces that shape the context of APEC?

The peculiar, unanticipated end of the Cold War left an awesome void of vision in the camp of the victors. The Soviet empire and its ideological underpinnings collapsed not as a result of defeat on the battlefield but through a massive implosion of the system. Rarely in history had the components of world order changed so abruptly. The victorious powers were left with no clear understanding of what had happened or what was to follow. A naive triumphalism filled the void. In the summer of 1989 a State Department official, Francis Fukuyama, published an essay entitled "The End of History" which drew international attention and bespoke this triumphalism. The essay proclaimed that, having defeated the forces of fascism and communism in the 20th century, the West had triumphed in grand historical terms. Fukuyama declared that the United States and its allies had achieved "the end point of mankind's ideological evolution and the universalization of Western liberal democracy." There were, at last, no ideological competitors. "The triumph of the West, of the Western ideal," he wrote, "is evident . . . in the total exhaustion of viable alternatives to Western liberalism."¹

¹ *National Interest*, Summer 1989.

Kenneth B. Pyle is president of The National Bureau of Asian Research and professor of history and Asian studies and former director of the Henry M. Jackson School of International Studies, University of Washington.

© 1995 by The National Bureau of Asian Research

Having no new goals and no concept or paradigm to replace the Cold War and seeing no immediate threats to security, American policy was beset by inertia and a lack of vision. Institutional rigidities, including adherence to the prevailing alliance system, held sway. American leadership groped with limited success to redefine security in the post-Cold War circumstances. In contrast to the aftermath of other great wars, the victorious powers have not clearly articulated a coherent definition of what constitutes security in the new era and accordingly have not created new institutions to maintain it. What is the nature of security? What are the underlying principles? What are the priorities? American triumphalism, having no new goals, is content with the old institutions in a modified form, a continuation of the American security blanket for the region, with a continuation of the same goals now defined simply as "enlargement," and with the further extension of economic liberalism.

In Asia there is another form of triumphalism. The Cold War masked the emergence of not only the Japanese economic superpower but also the emergence of other substantial economic powers like South Korea, which were driven by a suppressed nationalism now coming to light with the end of the Cold War. This hitherto suppressed nationalism is now expressed in the confident belief that prosperity is the result of the unique values and institutions of countries in the region. Malaysian Prime Minister Mahathir Mohamad, Singapore's diplomat Kishore Mahbubani, and many others have expressed these views. For the most part this optimism has been expressed in criticism of Western values, and a clear vision of a future regional order is not yet apparent. Hence the argument that APEC must take an organic, evolutionary approach.

The most ambitious and bold effort to propose a new paradigm is the work of Yasuhide Murakami, a seminal thinker who has been called the Max Weber of Japan. Prior to his untimely death in 1993, Murakami had become the leading thinker of the Japanese internationalists who gained influence in the 1980s under Prime Minister Yasuhiro Nakasone. When the Cold War came to an end in 1989, Murakami was appalled by Western triumphalism. Shortly before his death he published a magisterial work of grand historical analysis, *Han-koten no seiji keizai-gaku* (*An Anticlassical Political-Economic Analysis*), in which he wrote, "Some people regard [the collapse of the Soviet socialist system] as a victory of European and American style capitalism and believe that they can celebrate the fulfillment of European modernity. But... this victory contains the seeds of self-destruction." He added, "It is not history that is about to end but the modern age of Western origin." Murakami's work argued that Western capitalism had lost its universal value as a model and that a new form of Asian capitalism, pioneered by Japan and adopted in other East Asian countries, was the wave of the future.

The extraordinary increase in the economic strength of countries in the region and their growing self-assertion highlight the uncertainty about the security dimensions of the future regional order that must support APEC. At the heart of this uncertainty is the future of U.S.-Japan relations. For the intermediate future, a major determining factor of the dynamics of the regional order is this bilateral relationship. Japan-U.S. relations are pivotal because they link dominant military and dominant economic power and thus provide the potential for a strong stabilizing force in the region. This paper, as part of an examination of the broader setting of APEC, explores the trajectory of the U.S.-Japan relationship, analyzes the controlling forces for change, and examines the efforts of both countries to deal with the post-Cold War reality of the region. Both Japan and the United States are undergoing major changes in their relationship to the international system. How these transitions work out will determine the possibility of common purpose and the likelihood of a continuation of the alliance. Of the two, Japan's emergence as an economic superpower and its historic transition is the more dramatic and problematic.

Japan and the International System: The Historical Legacy

Little in Japan's two-thousand-year history has prepared it for this new era in the Pacific in which it must play a leading role. Since Japan entered the international state system in the middle of the 19th century, its foreign policy has had several distinctive traits, none of which is conducive to the role of regional and international leadership it is expected to play. First of all, Japan has been a reactive state in its foreign relations. Since the Meiji Restoration of 1868 Japanese leaders have been keenly sensitive to the forces controlling the international environment; they have tried to operate in accord with these forces and use them to their own advantage. As a late developer, Japan learned to be responsive to conditions established by the powers and to react to opportunities that presented themselves. In the middle of the 19th century, when the West demonstrated its power by opening Japan, the Japanese quickly reacted by building a modern industrial economy; in the age of imperialism at the turn of the century Japan became an imperialist; after World War I, the Japanese accepted the Wilsonian redefinition of the international order. Only once, in the 1930s, did Japan abandon this cautious and circumspect approach—and even then many of Japan's leaders thought they were acting in accord with the trend of the times. After the end of the American occupation in 1952 the reactive nature of the Japanese state was even more pronounced. Adapting to the new conditions of the *Pax Americana* and the expanding free trade order that it fostered, Japan depended on its special relationship with the United States to take maximum advantage of the changed international system.

For most of the postwar era Japan has been almost wholly a passive, reactive actor in the international system. As a vice minister of international trade and industry said, in 1986, "Japan has usually considered the international economic order as a given condition and looked for ways in which to use it."² Prime Minister Kiichi Miyazawa, shortly before visiting Washington in the spring of 1993 for his first meeting with President Bill Clinton, told reporters that *gaiatsu* (external pressure) was necessary for the Japanese system to change. Foreign pressure, he said, is like a "mother telling her children to do this or not to do this, otherwise your neighbor may laugh at you; that is the way of education in this country." Japan would continue to need such prodding because *gaiatsu* is "just perhaps part of our culture," a way for Japan to adjust itself to "the modern world."

A second fundamental trait of Japan's international relations is that pragmatic nationalism more than fixed principles has been Japan's guiding philosophy. An opportunistic adaptation to international conditions in order to enhance the power of the Japanese state has been characteristic of Japanese foreign policy. The modern revolutions of other countries were impelled by rising middle class demands for political rights, equality, and democracy. But the Meiji Restoration—Japan's modern revolution—was first and foremost a pragmatic nationalist response by a rejuvenated elite to the threat that Western imperial power constituted for the Japanese state. One of the Foreign Ministry's leading thinkers recently responded to an American journalist's inquiry as to the place of fixed principles in Japanese foreign policy with the riposte that "the histories of our two countries are different. Your country was built on principles. Japan was built on an archipelago."³ Japan, he seemed to say, could not afford to take a stand on principle; its economy and geopolitical position made it too vulnerable; its peculiar dependence on trade left it with a feeling of insecurity that engendered a cautious, deliberate foreign policy, marked often by a narrow pursuit of self-interest.

² Look Japan, September 10, 1986, p.4.

³ Hisahiko Okazaki, "Aja chotaiken e no shinsenryaku," in *This is Yomiuri*, August 1992, pp. 42-90; translated as "Southeast Asia in Japan's National Strategy" in *Japan Echo*, vol. 20 (special issue 1993), p. 61.

A third legacy of Japan's foreign relations is the relative lack of positive experience in international organizations. Japan's historical position as a late-developer often cast it into the role of opposing the international status quo. Although Japan was a founding member of the League of Nations, occupying one of the five permanent seats on its Council, it was the only one not to have submitted a draft proposal for the League. Although Japan sought the permanent Council seat for the status it accorded, there was little expectation that the League would serve Japan's interests. Japan's indifference to the League was apparent from the relatively low level of personnel contributed to the League's secretariat. Following seizure of Manchuria, the League voted 42 to 1 to condemn Japan, and it immediately quit the League. The next multi-lateral involvement, the 1940 Tripartite Pact with Germany and Italy, though not a tightly binding agreement, was a part of the greatest tragedy in Japanese history. When World War II ended and the United Nations was founded, its charter referred to Japan as a former enemy state; those clauses still remain. Japan became a member of the United Nations in 1956 but has played a limited role. Although Japanese citizens have headed the UN health, refugee, and Bosnian operations, the personnel contributions are still limited. As of 1992, 89 Japanese filled professional UN posts, less than half the 194-person mean (based on Japan's financial contribution to the world body). Japan is the second-largest financial contributor to the United Nations, but in terms of personnel contributions it is last compared to 19 other top donor nations.

A final historical constraint on Japan's capacity for international leadership is the difficult legacy of its relations with Asia. In the first four decades of the postwar period, Japan's relations with the rest of Asia were distant and largely limited to trade. The former empire had left a legacy of bitterness toward Japan in other Asian countries. The American occupation required the Japanese to make reparations, but on the whole Japan withdrew from close political ties and concentrated on rebuilding its own national livelihood.

Postwar foreign policy was shaped by the shrewd economic nationalism of Prime Minister Shigeru Yoshida (1946-54), who determined to adopt a passive role in the Cold War. He resisted U.S. efforts at the time of the Korean War to engage Japan in collective security agreements with other Asian nations. In the best Japanese tradition of pursuing pragmatic nationalism and adapting to world trends, he was determined to use the circumstances of the Cold War to Japan's advantage and to pursue a narrowly defined sense of economic self-interest. Yoshida contrived to keep Japan lightly armed and to trade bases on Japanese soil for a U.S. guarantee of Japanese security. It became an anomalous arrangement with astonishing longevity, and it epitomizes the peculiar context within which APEC evolves. Today, a half century after the end of the war, despite Japan's per capita GNP having risen to a level 50 percent higher than America's, 63,000 Americans remain at 94 military sites scattered about Japan.⁴

Avoiding any collective security commitments in Asia became an *idée fixe* of postwar Japanese diplomacy. Yoshida and his successors resisted an American effort to create an Asian counterpart of the North Atlantic Treaty Organization (NATO). They built an elaborate set of policies to prevent Japan's being drawn into any overseas commitments whatsoever. When the Japanese Self-Defense Forces were organized in 1954, the upper house of the Diet passed a unanimous resolution opposing their overseas dispatch. Subsequent prime ministers held the fixed position that any collective security agreement would be unconstitutional. Other subsequent, complementary policies included the three nonnuclear principles (not to produce, possess, or permit the introduction of nuclear weapons in Japan), the three principles proscribing arms and military technology exports, and the limitation of one percent of GNP for defense spending.

⁴The New York Times, July 16, 1995. 46,000 are members of the U.S. armed forces.

Pyle

By maintaining a narrow interpretation of the constitution, Japan's conservative leaders were able to limit positive commitments to the Cold War effort in Asia. Yoshida's firmness allowed Japan to avoid involvement in the Korean War. Similarly, in the case of the Vietnam conflict, while South Korea dispatched more than 300,000 troops, the Japanese were spared direct military involvement. Moreover, Tokyo avoided accepting refugees from Indochina. As of the end of 1994, Japan had permanently resettled less than 10,000 of the nearly 1.3 million refugees. Even distant Germany, a slightly smaller country, had accepted more than twice the number of refugees from Indochina as Japan.⁵

The Yoshida strategy had many successes, but in the long run it also had major drawbacks. It created a political-economic system in which the economic bureaucrats in the Ministry of International Trade and Industry, the Ministry of Finance, and the Economic Planning Agency, working cooperatively with conservative interests in business, guided the country's fortunes to achieve long-term goals, but it left the country unprepared to deal with the political consequences of this newly acquired economic power. Moreover, it ignored latent issues of wounded national pride caused by the subordinate role Japan adopted in the American world system. Political issues of war responsibility were left to fester, and international respect and trust were never fully restored. Two major developments in the last decade have begun to erode the basis of the Yoshida strategy and impel Japan toward a new foreign policy: 1) a vastly increased stake in the Asian economy, and 2) the new post-Cold War strategic environment.

Japan's Economic Surge Into Asia

A remarkable confluence of developments in the mid-1980s, constituting one of the most momentous changes in modern Japanese history, led to Japan's economic surge into Asia. Heretofore, Japan had kept its manufacturing base at home, but the new economic fundamentals made a dramatic change necessary. The most important development that provided the opportunity to establish a strong new economic role in the Asia-Pacific region was the Plaza Hotel Accord of 1985 and the sharp rise in the value of the yen that followed. At the Plaza summit, the leading industrial nations agreed to increase the value of the yen from 260 to 180 yen to the dollar. This international agreement made it profitable to shift the production and assembly of many Japanese manufactures to other Asian countries with lower wages. Thereafter, the yen continued to rise, making offshore manufacturing increasingly attractive. In addition, foreign direct investment (FDI) was made more attractive by rising production costs at home, Japan's tightening labor market, the change in comparative advantage, and the proximity of Asia's booming markets. Other significant developments at the same time included Japan's emergence as the world's largest creditor and donor of official development assistance (ODA), liberalization of the Japanese capital market, and foreign pressure to restructure the Japanese economy so as to reduce its trade surpluses and to increase the import of manufactured goods.

North America and Europe absorbed much of Japanese FDI, but Asia's share grew rapidly. By 1991 Japan had become the largest foreign investor in Singapore, Hong Kong, the Philippines, and Thailand, and the second largest in Taiwan, Indonesia, and Malaysia. By 1992 Japan had \$19.6 billion invested in the newly industrialized economies of Asia and \$35 billion in the countries of the Association of Southeast Asian Nations (ASEAN). Asian nations offered a growing market for Japanese goods. From 1986 to 1993 Japan's trade surplus with Asian countries rose from \$16.4 billion to \$55.6 billion, exceeding its surplus with the United States for the first time. Hisahiko Okazaki, a former ambassador to Thailand and a brilliant strategic thinker, in a long and thoughtful essay in 1992, advocated investment in Southeast Asia and the Chinese

⁵ Figures cited in the *Japan Times*, December 13, 1994.

coast as "a springboard for future economic expansion." Okazaki saw the rise in the value of the yen after the Plaza Accord offering Japan an extraordinary opportunity to use FDI to create the basis for international leadership:

If Japanese overseas investment in the manufacturing industry continues unabated for another ten years, or even until the end of this century, this country is likely to find itself in a position comparable to that of Britain in the nineteenth century or the United States during the middle of the twentieth, racking up long-term trade surpluses and freely investing its excess capital overseas. This means Japan's influence will be felt in some way or another in every major area of world economic activity. Even after its competitiveness declines, Japan, like Britain and the United States today, will have enough accumulated assets abroad to sustain future generations. Thus, overseas investment is also a good strategy for an aging society like Japan's.⁶

It was in the fundamentals of these new economic interests that a coherent Japanese strategy in Asia began to take shape. This strategy was wholly driven by economic considerations. A half century of single-minded attention to promoting economic growth ensured that the principal motive forces of national life were the economic dynamism of Japanese firms, the institutional framework within which they operated, and the values of economic rationality that supported and motivated them. While the institutional legacies of the postwar experience continued to limit severely its competence in foreign policy, Japan moved swiftly and adeptly to seize a leadership role in Asia's economic dynamism once domestic and international structural change made it attractive. The task of formulating a comprehensive and coordinated approach to Asia in terms of economic policies fit the postwar inclination of the Japanese state, with its strength in economic institutions, capacity for bureaucratic planning and coordination, and ability to fine-tune policies to enhance market forces.

What began to emerge was a series of policies to promote a regional division of labor under quiet Japanese leadership—a strategy that sought to lay the basis for a "soft," regionwide integration of economies under Japanese leadership. In assessing the Japanese economic strategy in Asia, it is important to stress that much analysis has missed the mark. As Kozo Yamamura points out, "Japan is not building an inward-looking trade bloc or a yen bloc but vertically integrated production networks with increasing market power."⁷ Since the mid-1980s Japanese multinationals and their *keiretsu* firms have been making huge investments to establish production networks across Asia. The inter-firm relations that proliferated during the high growth period at home are being replicated in Asia. That is, the small and medium-sized firms belonging to vertical *keiretsu* at home are following their parent firm abroad. In addition, majority-owned subsidiaries and local Asian firms are drawn into these networks. As Yamamura observes, "in both the automobile and electronics industries, a large and growing number of these 'local' suppliers used by Japanese manufacturers in Asia actually are Japanese firms." For example, a Matsushita television plant in Malaysia depends on local suppliers for 55 percent of its parts, but over 90 percent of these parts are produced by Japanese affiliated firms in Malaysia. As the Foreign Ministry's Okazaki wrote in 1992, by establishing offshore production networks in Southeast Asia it would not be necessary to worry about protectionism, nor would it make sense to seek an inward-looking trade bloc:

When the bulk of trade consists of captive imports from factories built through direct investment and the captive export of machinery and materials needed to produce such merchandise, there is little need to worry about protectionism. Indeed, current investment patterns are more likely to cause friction with areas outside the region than within it, as Western nations

⁶ Okazaki, *op. cit.*

⁷ Kozo Yamamura, "Japan's Production Network in Asia: Regionalization by *Keiretsu*?", unpublished paper, University of Washington, 1994.

begin to suspect Japan of exporting its system of vertically integrated corporate groups, or *keiretsu*, and shutting other industrial countries out of the market.⁸

The implication of this strategy was that so long as Japan maintained control of the move to offshore production networks and the process of captive imports and exports was maintained this would work to Japan's advantage. In contrast to what had happened in the United States, wrote Yuji Masuda of Tokyo University in 1994, "this is not a 'hollowing-out' of the structure of the Japanese economy but positioning Japanese industries and firms at the core of the networks that are now covering all of the Asian economies."⁹

Japan's net external assets rose from \$10.9 billion in 1981 to \$383 billion a decade later. By 1990 Japan had become the largest net creditor in the world—as Edward Lincoln has written, "the greatest creditor nation the world has ever known." In 1970, Lincoln notes, the cumulative value of Japanese overseas investments was \$3.6 billion; in 1980, \$160 billion; and in 1991, \$2.0 trillion.¹⁰ As a consequence Japanese were drawn into international affairs in a way unprecedented in Japanese experience. Earlier Japanese contact with the world through trade allowed the foreigners to be kept at arm's length. Imports and exports were most often handled through large general trading companies which required relatively little real contact. But the new investment patterns required genuine economic intimacy with other peoples. As Lincoln observes, "Successful direct investments require an understanding of foreign cultures, legal systems, idiosyncratic conditions in local financial and real estate markets, political systems, labor supply conditions, labor law or customary work conditions, and a tolerance and acceptance of diverse ethnic and racial groups."¹¹

This new human interaction with foreign peoples led the Japanese to think of the new era as one of *kokusaika*, or internationalization. The challenge of achieving a closer relationship with Asia was one of the significant aspects brought on by this period of internationalization. For four decades Japan had remained aloof from Asia, concentrating on investment and production at home. But the new economic forces radically changed this situation, and Japanese interest in the development of other Asian economies dramatically increased.

At the same time, it was difficult for Japan to exert political leadership in Asia because of the legacy of World War II. Japan's postwar conservative leaders had not dealt forthrightly with the Japanese role in Asia during the war. While many Japanese were severely self-critical in assessing Japan's wartime role, most mainstream conservative leaders were not.

The internationalists who advised Prime Minister Nakasone had tried unsuccessfully to deal with these issues. They argued that with such great new overseas involvement it was in Japan's national interest to abandon the Yoshida strategy and adopt a new role abroad. Nakasone and his advisors argued that Japanese had to develop a more liberal nationalism which would understand the need for a broader national purpose and a more active and responsible role in the United Nations and other international organizations. They stressed that Japanese must develop new and friendly relationships with other Asians to provide legitimacy for Japanese political-economic leadership in the region.

Nakasone left office in 1987 disappointed with the failure to realize a reorientation of national purpose. Despite the change in Japan's economic fundamentals, the balance of power was still with the policies of the past. Nakasone was attacked on all sides: by the bureaucracy

⁸ Okazaki, *op. cit.*

⁹ Quoted in Yamamura, *op. cit.*

¹⁰ Edward J. Lincoln, *Japan's New Global Role*, Washington, DC: Brookings, 1993, pp. 59–62; also Lincoln, "Japanese Trade and Investment Issues," in Danny Unger and Paul Blackburn, eds., *Japan's Emerging Global Role*, Boulder, CO: Lynn Rienner, 1993, p. 135.

¹¹ Lincoln, *Japan's New Global Role*, *op. cit.*, p. 58.

for overriding its prerogatives in trying to revise its narrow policies of self-interest; by the mainline conservatives who wished to hold to the successful Yoshida policies; by left-wing parties which saw him undermining the constitutional limits on Japanese foreign policy. As the Cold War abruptly ended at the close of the 1980s, Japan was still divided, adrift, and reactive in its foreign policy. The new post-Cold War strategic environment, however, provided further impetus, along with the changed economic fundamentals, to a decline in the Yoshida strategy.

The Post-Cold War Decline of the Yoshida Strategy

The purposeful and well coordinated advance of Japanese economic interests into Asia at the end of the 1980s provided a sharp contrast to the political immobilism that characterized Japan's response to the Persian Gulf War and the hesitant Japanese participation in Cambodian peacekeeping operations. The Gulf War was the first international crisis of the post-Cold War era, and Japanese leadership was wholly unprepared to deal with the new context of its foreign policy. The storm of international criticism that greeted the grudging support Japan gave the UN-sanctioned coalition stunned Japanese politicians. Protestations of constitutional inhibitions were no longer persuasive for a country of such economic power and prominence. Although Japan eventually contributed \$13 billion to the coalition, the failure to provide personnel in any form was widely criticized.

In the face of this international criticism, a new generation of assertive political leadership in the LDP demanded a reinterpretation of the constitution. The most prominent of these younger leaders were Ichiro Ozawa and Ryutaro Hashimoto. Ozawa dismissed the government's long-standing constitutional interpretation prohibiting overseas deployment of troops as a "subterfuge" of the Yoshida strategy, which he said had made Japan selfish and money-grubbing, ignoring the cost of maintaining the international freedom and peace upon which the Japanese economy depended.¹² Ozawa, whose thinking closely resembled Nakasone's, although the two were not close, headed a study group of the Liberal Democratic Party (LDP) on Japan's role in international society. In early 1992 the group recommended a reinterpretation of the constitution. "Japan," the report said, "is being asked to shift from a passive stance of mainly enjoying the benefits of a global system to an active stance of assisting in the building of a new order."¹³ The commission recommended a revision of the Self-Defense Forces Law so as to provide explicit legal foundation for what it called "international security," that is, collective security efforts sanctioned by the United Nations, such as participation in UN peacekeeping operations, a UN army, and UN-sanctioned multinational forces. The report did not, however, approve the concept of collective self-defense, which would allow the U.S.-Japan Mutual Security Treaty to be reciprocal.

Following intense debate the Diet passed the UN Peacekeeping Operations (PKO) Cooperation Bill on June 15, 1992, which ended the ban on dispatching Self-Defense Forces (SDF) troops abroad. It limited troop deployment, however, to logistical and humanitarian support, monitoring elections, and providing aid in civil administration. Under a compromise required to gain the support of small opposition parties, a section of the law entailing SDF involvement in armed UN missions, such as monitoring cease-fires, disarming combatants, and patrolling buffer zones, was frozen for the time being.

Passage of this legislation, as limited and constrained as it was, marked a significant step in the decline of "Yoshida politics." One sign of the erosion of the national consensus which

¹² *Asahi Shimbun*, November 29, 1991.

¹³ *Asahi Shimbun*, February 21, 1992.

the Yoshida strategy had held together throughout the Cold War was the diehard opposition to the PKO bill of the Socialist Party, whose lower-house members in symbolic protest submitted their resignations before the vote. It was the first major challenge to the foreign policy consensus since ratification of the U.S.-Japan Mutual Security Treaty in 1960 which had led to the largest mass demonstrations in Japanese history. In this case, however, the left-wing opposition failed. With the Cold War ended, the climate of opinion was unresponsive to its protest.

After passage of the PKO legislation, the government dispatched in September 1992 the first of a contingent of 600 soldiers for road and bridge repair, eight election monitors, and 75 police officers to join the UN peacekeeping mission in Cambodia. Participation in the United Nation's 22,000-member peacekeeping operation intended to end Cambodia's long civil war was a test case for the Japanese. It marked the first direct postwar involvement in military-strategic affairs in Asia. It was the first time since World War II that Japanese ground forces were dispatched to foreign soil.

Public support of participation in the Cambodian operation was fragile. The Japanese public tended to justify dispatch of SDF troops largely in terms of satisfying foreign criticism of Japan's failure to make personnel available to international peacekeeping. Typically, Japanese public discussion held that it was necessary for Japan to make a symbolic "contribution" to satisfy this criticism.

Self-Defense Forces, together with civilian police officers and election monitors, served under the UN Transitional Authority in Cambodia (UNTAC). Along with the Japanese peacekeepers came hundreds of Japanese reporters and cameramen intent on assessing the venture. It was fortunate that UNTAC was headed by a veteran Japanese diplomat, Yasushi Akashi, who understood the exceptional nature of the Japanese operation. Members of the SDF operated under a bewildering set of rules of engagement. Unlike other UN peacekeeping forces, the Japanese could use their weapons only in self-defense. They could not use them if they were obstructed in their duties or to protect other nationals. As one former Japanese general explained, "For the SDF to fire on the Khmer Rouge to protect non-Japanese would represent an exercise of the right of collective self-defense which the government has ruled out."¹⁴

UN officials were reportedly bitter over the special circumstances under which the Japanese peacekeepers operated. Even Akashi compared them to "maidens" because they were "rather timid and tentative." He described the Japanese participation as "teething experiences."¹⁵ In fact when a Japanese volunteer, not part of the official mission, and a Japanese policeman were killed in the spring of 1993, the Japanese media went into a "feeding frenzy," pandering to the public's shock at this first loss of Japanese life. Leading Japanese newspapers leaned toward withdrawal from UNTAC; a member of the cabinet also favored withdrawal; and the government dispatched a mission to seek relocation of Japanese participants to even safer areas. According to UN records, more than 20 Japanese policemen, nearly a third of the total, fled their assignments, taking their UN vehicles back to the safety of Phnom Penh. Four Japanese peacekeepers deserted the country and drove their UN vehicles across the border to Thailand, taking refuge in the Japanese embassy in Bangkok. A senior UN official remarked that "the only time the Japanese were tested by fire, they abandoned us. We understand the special constitutional restrictions on the Japanese, but in a situation of undeniable danger, how can we repeatedly ask people of one nationality, but not another, to take risks?"¹⁶ In the end the elections came off smoothly and the Khmer Rouge, for whatever reason, did not attack

¹⁴Sachio Genkawa and Akihiko Ushiba, "Nakata Atsuhito-shi no 'ikun,'" *Shokun*, June 1993; translated as "The Peculiar Constraints on Japan's Peacekeepers," in *Japan Echo*, vol. 20, no. 3 (Autumn 1993), p. 9.

¹⁵*The New York Times*, October 24, 1993.

¹⁶*Ibid.*

other Japanese. Had more Japanese been killed it almost certainly would have disrupted the mission. Ozawa expressed surprise and relief that the Japanese had not been targeted.¹⁷ Successful completion of the Cambodian operation was an important point in the slow evolution of reorienting Japan's international role.

Groping for a Political Strategy in Asia

The sharply increased economic importance of Asian economies to Japan had to be supported by a new long-term political strategy. To underwrite its economic interests, the emerging strategy had four parts: 1) to reassure Asians that Japan would not translate its economic strength into military power; 2) to maintain a strong public commitment to the U.S. alliance to demonstrate Japan's intention of not becoming an independent military power; 3) to develop cultural policies that would strengthen Japan's identity as an Asian nation; and 4) to pursue an increased political role in Asia by working through multilateral institutions and fora.

Suspicion and concern over Japanese intentions were still high when the Cold War came to an end. When Japanese minesweepers were dispatched to the Persian Gulf in May 1991 to aid in the cleanup operation after the Gulf War, former Singapore Prime Minister Lee Kuan Yew worried that allowing the Japanese defense forces to participate in overseas operations was like "giving liquor chocolates to an alcoholic."¹⁸ It was not only memories of World War II that had to be overcome. Japan's subsequent aloofness from the region and narrow pursuit of its economic self-interest during the Cold War also deferred the task of restoring trust. The Yoshida strategy was a shrewd way to pursue Japan's postwar interests and to restore Japan's position of power and importance, but "what would have happened," Hisahiko Okazaki recently mused, "if Japan had pursued a normal military policy within the context of its postwar foreign policy framework, including the Japan-U.S. Security Treaty?" Okazaki speculated that active participation in the Cold War effort in Asia and in the Gulf War would have engendered "a relationship of trust and a sense of camaraderie" with other Asian nations: "A country wins the confidence of other nations through the repetition of such acts. Foreign peoples and governments have no way of knowing whether Japan is really the sane and responsible country it claims to have become until they have had a chance to observe it in action." Owing to the pursuit of the Yoshida strategy for the past forty years, "Japan forfeited its chance to build up a record as a country deserving of international trust." Economic aid also failed to win confidence in Asia as "the widespread perception of Japan as a country driven purely by economic motives makes this difficult."¹⁹

To reassure Asians it became almost a mantra repeated by Japanese officials that Japan would never again become an independent military power. As a Ministry of Finance report in 1990 emphasized, Japan, "learning from the lessons of history," would remain a "non-military economic power," a "non-ideological nation," and a "new-style peace-loving and cultural nation."²⁰

Similar themes were repeated throughout the early 1990s. In 1992 Prime Minister Miyazawa appointed a Roundtable on Japan and the Asia-Pacific Region in the 21st Century, chaired by the president of Keio University, Tadao Ishikawa, a scholar of modern Chinese affairs. Characterized by extreme caution and circumspection, the roundtable's final report, issued just prior to Miyazawa's tour of Southeast Asia at the beginning of 1993, emphasized that Japan could no longer remain aloof from the problems of Asia but rather must take a more active political

¹⁷ Personal interview with Ozawa, May 1993.

¹⁸ *International Herald Tribune*, May 4, 1991.

¹⁹ Okazaki, *op. cit.*

²⁰ Foundation for Advanced Information and Research, *Interim Report of Asia-Pacific Economic Research*, Tokyo: FAIR, 1990, pp. 217, 226.

Pyle

role in the region. But the meaning of this emphasis was left vague, and the entire tenor of the report on the contrary implied a continued low profile.²¹ The prime minister's speeches on the tour, which were supposed to enunciate a "Miyazawa Doctrine" by announcing a greater political profile for Japan in Asia, were even more bland than the report. Commenting on the prime minister's speech in Bangkok, which assured Asia that Japan would "never again become a military power" and would "always think and act together" with Asian peoples, the *Nikkei Weekly* derided Miyazawa for his blandness and said it raised questions about the purpose served by organizing this study group in the first place.²²

Given the evidence of Asia's new economic dynamism and Japan's deeper economic ties to the region, some Japanese leaders were prepared to abandon a defensive stance and advocate closer identification with Asia. They advocated policies that would enhance awareness of common cultural traditions that Japan shared with Asia. One such effort that drew considerable attention was a 1993 essay by a high-level Foreign Ministry official, Kazuo Ogura, asserting that "Western-style modernization and industrialization [had reached] a dead end."²³ It was necessary to abandon seeing Asia in the negative light of the Western world view, as stagnant, passive, authoritarian. Asia at the end of the 20th century was becoming dynamic, active, and the new source of universal values. An "Asian restoration" must begin by overcoming past animosities among Asian countries:

It will be difficult for Asia to take off and soar again unless it can get over the legacy of ill will caused by past invasions and strife. . . . Japanese awareness and contrition alone will not suffice. . . . The countries that were injured will have to refrain from being prisoners of the past and adopt a future-minded position.

Another step important to the rise of Asia, he wrote, was overcoming the influence of the Western-trained Asian elites who were tied to a Western mind-set:

As we prepare for the twenty-first century, we must seriously reexamine the role of these Western-oriented intellectuals and leaders . . . [who] are using their links with the West to maintain the legitimacy of their superior position. What we see is in a sense a survival, although under a different guise, of the old colonial arrangement by which natives with Western learning could skillfully develop ties with the rulers and thereby dominate the un-Westernized general populace. Under these circumstances, members of the political elite have been hesitant to stress Asian values lest they undermine the legitimacy of their own power.

To remedy this situation, Asia must begin to train its own leaders. Asia could produce universal values to transmit to the world by developing a "theory of Asian capitalism."

What Asia has treasured is the view of society and human beings that underlies such areas as Japanese-style management, lifelong education, and family upbringing, and it has also treasured the economic and social systems that are built on this view.

Ogura clearly had in mind the Japanese economic system when he spoke of Asian ideals that had universal significance. When he spoke of a "theory of Asian capitalism" he left no doubt that Japan was the model. To spread these Asian values, to bring about an "Asian restoration," it was necessary to set up study centers as alternatives to the traditional Western centers of learning where Asian students had been going.

²¹ Roundtable on Japan and the Asia-Pacific Region in the 21st Century, unofficial translation of final report, December 25, 1992.

²² *Nikkei Weekly*, January 25, 1993.

²³ Kazuo Ogura, "Aja no fukken' no tame ni," *Chuo Koron*, July 1993; translated as "A Call for a New Concept of Asia," in *Japan Echo*, vol. 20, no. 3 (Autumn 1993), pp. 37-44.

Ogura's views were representative of a growing belief in mainstream thought that Japan's international role in the post-Cold War era must be defined in terms of regional leadership and a stronger identification with Asia. Another example of this view is found in the writings of Yasusuke Murakami, a theoretician of the neo-conservative thought that underlay Nakasone's policy positions during his prime ministership. Murakami and Nakasone in fact coauthored a prescription for the post-Cold War order in 1992. Murakami believed that Western values were losing relevance to the future course of history. In a 1988 essay he went beyond the common view that the West was experiencing a relative weakening of its economic and political power: "The very ideals sustaining modern Western society are being shaken to their roots. . . . The fact is that the Western tradition of philosophy has long since reached a dead end." Murakami wrote that it was "the Japanese challenge, a development of global historical significance," that demonstrated the decline of the West:

Japan has probably outdone Western Europe and North America in the guarantee of liberties. Based on objective national indicators, Japan also achieved greater equality than almost any country in the West. Most important, the secret of Japan's success relates at least in part to non-Western organization principles. In this sense, Japan's achievements represent a severe blow to modern Western ideals. Furthermore, the same phenomenon is occurring in Hong Kong, Singapore, South Korea, and Taiwan; what we seem to be witnessing is not simply a Japanese challenge but an Asian challenge, a development that cannot but call into question the very basis of the Pax Americana.²⁴

The New Context of Defense Strategy

Yet even the strongest advocates of a closer identification with Asia affirmed the essential nature of the U.S. alliance and the continued U.S. presence in Asia. In fact, across the spectrum of Japanese opinion, there is now near unanimity in supporting the Mutual Security Treaty. When the Socialist Party joined in coalition with the LDP to form a government in June 1994, the new Socialist prime minister, Tomiichi Murayama, explicitly abandoned the fundamentals of his party's postwar foreign policy. For forty years the Socialists had opposed the Self-Defense Forces as unconstitutional; they had supported unarmed neutrality, opposed American military bases and the U.S.-Japan alliance, and opposed recognition of South Korea. They had opposed the PKO Cooperation Bill of 1992 which allowed the SDF to be dispatched abroad. Murayama, the first Socialist prime minister in nearly half a century, abruptly reversed the party's policies on all these issues. Initially opposition Diet members derided his volte-face, but Murayama plunged ahead with more reversals, sanctioning the flying of the Rising Sun flag in schools, the singing of the national anthem, cabinet ministers' visits to the Yasukuni Shrine, defense of the sea-lanes, close ties with South Korea, purchase of AWACs planes, and use of nuclear power for domestic energy needs. The Socialist Party in a subsequent meeting approved these changes. With this sudden opportunistic reversal the principal foreign policies of the Japanese left wing were swept away; the postwar left-right axis in foreign policy virtually disappeared.

With the collapse of the left-wing foreign policy position the resistance to constitutional revision was weakened. In November 1994 Japan's largest daily newspaper, the *Yomiuri Shimbun* with a circulation of over ten million, published a draft proposal for revising the constitution. The draft proposal came out of a two-and-a-half-year study led by Masamichi Inoki, a widely respected scholar of national defense issues. The draft proposed replacing Article Nine, the no-war clause, with a provision permitting "an organization for self-defense, to maintain the peace,

²⁴ Yasusuke Murakami, "Daigaku to iu na no shinsei kigeki," *Chuo Koron*, July 1988, translated as "The Debt Comes Due for Mass Higher Education," in *Japan Echo*, vol. 15, no. 3 (Autumn 1988), pp. 71-80.

independence, and security of Japan."²⁵ At the same time, in order to reassure foreign concerns, it included the three nonnuclear principles and prohibited a military draft. A *New York Times*-CBS-Tokyo Broadcasting System poll in December 1994 found for the first time a majority of Japanese—53 percent—who said Japan should consider constitutional revision.²⁶

The cumulative changes in Japan's foreign policy position since the end of the Cold War required a fundamental review of national defense strategy and the consolidation of a national consensus. In February 1994 then Prime Minister Morihiro Hosokawa appointed an advisory panel of bureaucrats, business leaders, and intellectuals to recommend revisions in what had been the nation's Cold War defense strategy, the so-called National Defense Program Outline of 1976. The report of the advisory panel, issued on August 12, 1994, was characteristically cautious.²⁷ It strongly reaffirmed a defensive military posture and dependence on the security alliance with the United States. The report expressed readiness to do more to underwrite the American military bases in Japan. It called for further improvements in host-nation support and agreement to provide supplies (including fuel) and logistical service for U.S.-Japanese military exercises. Beyond the provisions recommended to make the alliance more reciprocal by increasing financial support, greater interoperability, and further steps to enhance joint military exercises, the most significant change the advisory panel recommended in the National Defense Program Outline was a more forward-looking stance on multilateral security activities. The report recommended revision of the Self-Defense Forces Law to provide for participation in UN peacekeeping activities as a primary duty. The activities would include monitoring of cease-fires, patrolling buffer zones, and other activities not presently permitted.

As it slowly moves away from the Yoshida strategy under the impetus of economic interests and the post Cold War environment, Japan is exploring the approaches of multilateralism in both economic and security fields. Multilateralism has many advantages for Japan. While bilateral relations with the United States remain critical both to the Japanese foreign policy position as well as to the domestic political structure, we have seen how relations with Asia have grown dramatically in importance since 1985. Japanese trade with Asia now exceeds trade with the United States. Japanese FDI in Asia is growing much more rapidly than Japanese FDI in North America. Nearly two-thirds of Japan's massive ODA goes to Asia. Japan's economic surge into Asia since 1985 requires more involvement in the region to protect its increased interests. Multilateralism provides some moving away and softening of the dominance of U.S.-Japan relations. While the historic legacy of the Pacific War is still not overcome, multilateralism provides a cover, a quiet approach to the region, one that will help to restore Japan's legitimacy and claim to leadership. Engagement in multilateral organizations not only offers a way to respond to foreign suspicions as well as criticism of its self-absorption, but also a way of overcoming domestic resistance to a more active international role. Without question one of the reasons that Ozawa, Nakasone, and other Japanese advocates of a "normal country" seek a Japanese permanent seat on the UN Security Council is to wean a substantial portion of the Japanese population of its residual pacifism or what is really isolationism. The United Nation's prestige has always been high with the old left wing of the political spectrum, and a UN Security Council seat would offer an avenue for increasing Japan's international engagement.

For all of these reasons, Japan has begun probing and exploring opportunities in multilateral fora and other organizations. It has encouraged the creation of the ASEAN Regional Forum (ARF) and the Council for Security Cooperation in the Asia Pacific (CSCAP), but characteristically has reserved its greatest efforts for APEC. With its loose, deliberative, informal nature, its

²⁵ *Yomiuri Shimbun*, "A Proposal for the Revision of the Text of the Constitution of Japan," Tokyo, November 3, 1994.

²⁶ *The New York Times*, December 30, 1994.

²⁷ Advisory Group on Defense Issues, *The Modality of the Security and Defense Capability of Japan: The Outlook for the 21st Century*, August 12, 1994.

concentration on economics, and its inclusion of the United States, APEC offers a multilateral organization with which the Japanese feel relatively comfortable. Japan has tried to position itself to serve as a bridge between Asia and the West. On the one hand, despite the urgings of many business leaders, Japan has resisted Malaysia's proposed East Asian Economic Caucus, which would exclude the United States, Australia, Canada, and other non-Asian states. A blue ribbon committee of the Japan Forum on International Relations, always reflective of the establishment's thinking, in a recent study stressed pursuit of a "constructive and open regionalism."²⁸ On the other hand, Tokyo has also resisted American efforts to move swiftly toward rules and regulations to establish trade and investment liberalization. Representing Asian apprehension that the United States will demand common rules of economic behavior, Japan has argued for respect of Asia's diversity and a gradualist approach—what the Japan Forum study called "organic economic integration guided by market mechanisms."

Driven by its economic interests but handicapped by its historic constraints, Japan is thus pursuing a cautious, low-key strategy in post-Cold War Asia. As Okazaki acknowledges, the legacy of the Yoshida strategy will be with Japan for some time: "If Japan had behaved in a conventional manner during the decades since the end of World War II, it could have undergone a smooth transition, taking its place in the world as a country with sufficiently good judgment to be trusted with normal military capabilities. But the opportunity to become a normal country has repeatedly eluded Japan." The Japan-U.S. alliance remains of the greatest consequence to Japan's future. Asia alone is no substitute. The policy of using East Asia as "a springboard" for economic expansion, which Okazaki advocates, cannot be pursued successfully "in the next 10 or 15 years" without the alliance. Asia alone is not sufficient to sustain Japan's growth for the foreseeable future. "Moreover, the ASEAN countries welcome Japanese expansion into the region as long as Tokyo maintains friendly relations with Washington." A rift with the United States would not only undermine Japan's Asian strategy: Okazaki acknowledges that he, in common with other Japanese elite strategists, believes that it would also result in domestic political upheaval. He therefore cautions against an "impetuous Asianism" or any harm to the health of the alliance: "It is vital not to damage the bedrock of the bilateral alliance, on which the fate of this nation rests."²⁹

The U.S.-Japan Alliance and the New Order

In the light of how essential the Japanese regard the alliance in their present transition period, the 1995 U.S. Department of Defense report entitled *United States Security Strategy for the East Asia-Pacific Region* was bound to be warmly welcomed in Japan. It changed the emphasis of a 1990 Pentagon report which had laid out a plan for phased cuts of American strength and for burden shifting to Asian allies. The 1990 report had created concern in Asia since it offered no institutional alternatives to the American security system which was to be downsized. In changed tones, the 1995 report asserted a resolve to maintain existing forward-based U.S. troop presence for the foreseeable future. Writing in *Foreign Affairs*, Assistant Secretary of Defense for International Security Affairs Joseph Nye, who supervised the report, saw no alternative to maintaining 100,000 U.S. troops in East Asia at least for the next decade. This presence, he said, was essential to maintain the basis for the region's prosperity and "ensures the United States a seat at the table on Asian issues." He offered no sense that this arrangement was a transition to a different future. APEC and ARF were described as "confidence-building measures" that would "complement American alliance leadership, not replace it."³⁰

²⁸ The Japan Forum on International Relations, *The Future of Regionalism and Japan*, Tokyo, June 1994.

²⁹ Okazaki, *op. cit.*

³⁰ Joseph S. Nye, Jr., "The Case for Deep Engagement," *Foreign Affairs*, July/August 1995, pp. 90-102.

Nye rejected the arguments of critics who said it was appropriate under post-Cold War circumstances to develop a new relationship with Japan. He gave little recognition to the anomalous nature of the U.S.-Japan relationship or to the new assertiveness and self-confidence that has arisen in recent years. The implication is that Japan will remain indefinitely in a security dependency role to the United States. Japan's substantial host-nation support was the only recognition Nye offered of the adjustment that was appropriate to reflect the massive change in relative economic strength that had taken place during the Cold War. The Nye report was received with relief in Tokyo where there was growing concern about China's military intentions. The outspoken Hisahiko Okazaki said what others were thinking: "Japan should cooperate with the U.S. to maintain the balance of power in the region against China. That is what Japan is expected to do by members of the Association of Southeast Asian Nations."³¹

Diehard Japanese adherents to the Yoshida strategy were elated by the Nye report. Former Prime Minister Miyazawa expressed his satisfaction in a remarkable interview:

The national security framework envisioned by Mr. Yoshida has not disappeared with the end of the Cold War, but now holds new meaning. I personally share the ideas presented in [the] Pentagon report . . . prepared by Joseph Nye. . . . We should allocate whatever is needed in terms of our host-nation support to secure the U.S. presence here. . . . Refraining from becoming a military power and applying restraints on the use of such power would better serve Japan's interest. Even if this country does decide to send troops overseas by revising the Constitution, who would want to go abroad? No one has the guts to rescue a woman being harassed by a drunkard on a commuter train. How can people like this hope to become a normal nation?³²

The implication of both the Nye report and the slow evolutionary approach to multilateralism embedded in the APEC and ARF organizations is that the United States will continue to provide the security for the region for the foreseeable future. How realistic is this approach? The U.S.-Japan alliance is key to answering this question. Given Japan's economic surge into Asia in the past decade and the role reversal that has taken place with the United States in terms of aid, trade, investment, and credit, the expectation that the American military can continue indefinitely to provide the security for this prosperous region may be unrealistic. It will be hard indeed to sustain congressional support for so peculiar an arrangement. The first security crisis that arises in Asia in which Americans are required to bear the responsibility could jeopardize this structure. The nature of Japan's economic penetration of Asia through reliance on *keiretsu* relationships is also likely to become a growing source of friction as the U.S. trade deficit with Asia grows. Increasingly, Congress will be inclined to link economic and security considerations. Even the Clinton Administration, despite its strong support of the present arrangement, has hinted at such linkage. For example, President Clinton, speaking at the APEC meeting in Seattle, November 19, 1993, said that "we do not intend to bear the cost of our military presence in Asia and the burdens of regional leadership only to be shut out of the benefits of growth that stability brings." Likewise, a strong implication of linkage between trade and security was evident in the recent Japan-U.S. auto parts dispute. Assistant Secretary of State Winston Lord told the *Straits Times* in Singapore that "over time, if the U.S. domestic perception is that the U.S. was being shut out of Asian markets, they might well begin to question the maintenance of forces in the region."³³

At a May 1995 Tokyo conference on the future of Asia, Asian leaders acknowledged the linkage of economics and security by arguing that the Americans must be rewarded with eco-

³¹ *Nikkei Weekly*, January 9, 1995, p. 1.

³² *Japan Times*, August 13, 1995, p. 21.

³³ Quoted in *The New York Times*, May 29, 1995.

conomic benefits for carrying the security burden of the region. Japan must open its markets, Lee Kuan Yew lectured the Japanese, or risk American military disengagement from the region: "If peace and stability, which Americans have helped maintain over the last 50 years, lead to an increasingly prosperous Japan, Korea, Taiwan . . . China, ASEAN, (and) Vietnam, but an increasingly less prosperous U.S., I don't see the U.S. Congress voting funds for the renewal of the Seventh Fleet and all the other things necessary to maintain the balance." Lee and other Asian leaders described the APEC process as more than an economic exercise to promote trade liberalization: it is a vehicle to anchor U.S. interests in the region to counter China's growing military and economic power and thus maintain "the stability that keeps East Asia's economic miracle going," as Jose Almonte, presidential security advisor in the Philippines put it. "APEC ensures a continuing presence in the region for the U.S.," Almonte concluded. C. Fred Bergsten, a U.S. member and chair of APEC's Eminent Persons Group, agreed that APEC should institutionalize a "high-level strategic trade-off whereby Asian countries engage the U.S. in economic terms to assure continued engagement in the area by the U.S. in security terms."³⁴ How viable is such a trade-off which implies economic benefits in return for containment of China? In a high profile op-ed article in the *The New York Times*, April, 18, 1995, Michael Lind, a senior editor at *Harper's*, asked "why should U.S. troops serve indefinitely as the security guards of a latter-day Greater East Asian Co-Prosperity Sphere from which many American products are effectively excluded?" Lind argues for "treating Japan as an equal, not a dependent," ending the security treaty, and maintaining an economic and military balance between Japan and China.

Similarly, Henry Kissinger, in the conclusion of his book *Diplomacy*, argues for greater realism in American foreign policy. He observes Asian coolness to Clinton's proposals for transforming APEC into a more institutionalized Pacific Community on the European model, and argues for a classic balance-of-power approach:

The relations of the principal Asian nations to each other bear most of the attributes of the European balance-of-power system of the nineteenth century. Any significant increase in strength by one of them is almost certain to evoke an offsetting maneuver by the others. The wild card is the attitude of the United States, which has the capacity—though not necessarily the philosophy—to function in much the same way that Great Britain did in maintaining the European balance of power until the two world wars of the twentieth century. The stability of the Asia-Pacific region, the underpinning of its vaunted prosperity, is not a law of nature but the consequence of an equilibrium which will need increasingly careful and deliberate tending in the post-Cold War world.³⁵

Conclusion

APEC can develop only in a stable security environment, and this depends upon a clarification and revitalization of the U.S.-Japan alliance based on the new realities of the last decade. These realities are the growth of Japan's economic power, its influence in Asia, and its self-assertiveness. Furthermore, the end of the Cold War has cut Japan loose from both its post-World War II domestic political and foreign policy moorings. A paradigm shift in the Japanese political system is under way, and Japan's leadership recognizes that the Yoshida strategy is no longer viable. In light of historic constraints, Japan is exploring an array of possibilities including constitutional revision, participation in collective security arrangements, a permanent UN Security Council seat, and closer ties with Asia.

If there should be a breakup of the U.S.-Japan alliance or if there is simply a weak or deteriorating bilateral relation, the region will be subject to uncertainty and instability and will

³⁴ *Nikkei Weekly*, May 22, 1995, p. 1.

³⁵ Henry Kissinger, *Diplomacy*, New York: Simon and Schuster, 1994, p. 826.

be governed by more classic balance-of-power dynamics. A restructuring of the alliance based on the new realities is essential. For the first time in its modern history Japan has become a status quo country, with enormous dependence on stability in the international system. In the abstract, the United States and Japan have parallel geopolitical interests. Revitalizing the alliance, however, faces many obstacles. First of all, there must be a harmonization of economic institutions so that the rules of the game in trade and competition are acceptable to both countries. Secondly, there must be closer cooperation on official aid projects. Third, a reciprocal alliance should entail sharing of dual-use technology. Fourth, a revitalized alliance must be predicated on Japan's playing an appropriate role in collective security. In a 1993 article entitled "Coping with Japan," Nye wrote that as a matter of strategy the United States should try to keep Japan in a special category of nation-state which he called a "global civilian power."³⁶ For the next several years, Japan would be happy to accept such a role. In the longer term, it is not realistic to expect that the continued operation of American bases on Japanese soil in their present form and status will be acceptable to a Japan inclined to return to orthodox nationhood. Nor is it realistic to perpetuate indefinitely a situation in which the United States alone is responsible for security and stability in the Asia-Pacific region.

A stable new order in East Asia must be governed by a set of generally accepted rules and institutions. APEC offers a beginning of a process that may lead to a partial framework of such rules and institutions. A new order must also be reflective of the relative strength of the major powers in the region. Because of its historic constraints and its present political flux, Japan has thus far not exercised political responsibilities commensurate with its economic strength. A stable post-Cold War framework requires that it make its long-delayed transition to a normal country with greater balance in its political responsibilities and economic capabilities. In the long run, the APEC process can thrive only in the context of a new Japan-U.S. relationship. □

* Joseph S. Nye, Jr., "Coping with Japan," *Foreign Policy*, Winter 1992-93.

TESTIMONY BEFORE THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON INTERNATIONAL RELATIONS
SUBCOMMITTEE ON ASIA AND THE PACIFIC

BY

KENT E. CALDER
PRINCETON UNIVERSITY

OCTOBER 16, 1995

THE BIRTH OF A NEW ASIAN POLITICAL ECONOMY:
IMPLICATIONS FOR AMERICA

by

Kent E. Calder

Princeton University

Over the past decade a profoundly new East Asian political economy has begun taking shape, with fateful implications for both America and its trans-Pacific economic partners. Throughout the postwar period the U.S. had, until the mid-1980s, consistently been both the dominant market and the dominant investment source for most nations of the region. That pattern is now rapidly shifting, with more fluid and pluralistic economic ties emerging. The new patterns pose major new challenges, both to American diplomacy and to this nation's business presence in the Western Pacific.

The traditional pattern of economic relations, which persisted from the Korean War until well into the 1980s, was what one might call the "trans-Pacific trade triangle." The U.S. invested in Asia outside Japan and, to a lesser degree, in Japan itself. In return, America imported finished manufactured goods, while sustaining huge trade deficits with both Japan and other parts of Asia. The U.S. could absorb huge deficits, due to its underlying affluence and the U.S. dollar's key-currency role, and serve as the engine for Asia's high-speed economic growth.

Over the past decade a profoundly transformed new East Asian political economy has been taking shape, with fateful implications for both America and its trans-Pacific partners. The new East Asia has four distinctive features: (1) interdependence among its members through investment as well as trade; (2) deepened economic ties across old Cold War boundaries, particularly to China and Vietnam; (3) a new energy equation; and (4) reduced reliance on economic ties with the United States. All four features of the new East Asian political economy have major implications for American Asia policy, in both its economic and security dimensions, as President Bill Clinton prepares for the Osaka APEC Summit.

From Exports to Investment

With well over half of East Asian regional GNP, Japan has cast a long shadow over East Asia ever since it re-emerged as a post-World War II economic force during the Vietnam War. Yet in 1985 Japan's relationship with the region still remained primarily a trading one, involving in particular large exports of capital and consumer goods to Southeast Asia, in return for raw materials. Japan's investment stakes in Asia, as suggested in Table I, were roughly equal to those of the United States.

TABLE I
U.S.-JAPAN INVESTMENTS IN ASIA (1985-1994)

(Unit = \$ billion)

	<u>1985</u>		<u>1994</u>	
	<u>U.S.</u>	<u>Japan</u>	<u>U.S.</u>	<u>Japan</u>
Indonesia	4.1	8.0	5.0	15.2
Hong Kong	3.1	2.8	10.5	12.7
Singapore	1.9	1.9	8.7	8.5
South Korea	0.8	1.5	3.0	4.9
Malaysia	1.2	--	1.9	5.6
Taiwan	0.8	--	3.1	3.7
Philippines	1.0	--	1.8	2.2
Thailand	1.0	--	2.9	6.5
China	--	--	0.9	6.2
Japan	9.1	--	31.4	--
TOTAL ASIA (outside Japan)	<u>13.9</u>	<u>18.0</u>	<u>37.8</u>	<u>65.5</u>

Note: U.S. figures in 1994 column are for December 31, 1993, while Japanese figures are for March 31, 1994, the end of Japan's 1993 fiscal year.

Sources: (1) U.S. Department of Commerce. Survey of Current Business, August, 1995.

(2) Keizai Kōhō Center. Japan: An International Comparison, 1995 edition.

By the mid-1990s, this picture had sharply changed.

Japanese direct foreign investment in Asia, as indicated above, had more than tripled, propelled outward from the home islands by a doubling in the yen's value, and by highly stimulative domestic monetary policies in Tokyo. Japanese investment had soared, especially rapidly into Hong Kong and a Southeast Asian complex of nations (Indonesia, Thailand, Malaysia, and Singapore), while also flowing heavily since the early 1990s into selected northern Chinese coastal centers like Dalian and Shanghai.

The contrast to American investment patterns in Asia is especially striking. U.S. investment has risen rapidly, to be sure, in Hong Kong and Singapore, the principal entrepôt centers of the region. Indeed, in Singapore American investment exceeds even that of Japan. Yet outside these two English-speaking centers of trade and finance, the U.S. business presence in Asia remains quite limited compared to that of the Japanese. It is focused heavily on capital-intensive energy projects and electronics fabrication.

The shift from exports to investment is not only a Japanese phenomenon. In the late 1980s South Korea and Taiwan also began investing heavily in Southeast Asia as their currencies steadily appreciated, and their domestic industrial competitiveness declined. Half a decade later this surge shifted toward the Chinese mainland, where Taiwan alone now has over \$15 billion invested.

For Pacific regional economic affairs, the implication of

this pervasive shift from exports to investment is clear: bilateral trade figures are becoming less and less useful to understanding real economic relationships in the region. In important sectors such as telecommunications equipment and consumer electronics, for example, American trade deficits with Japan have remained quite stable, after serious deterioration during the 1980s. Yet this superficial stability masks a growing imbalance in overall trade relationships with Japanese firms, since Japanese producers in these sectors moved production facilities en masse from Japan to Southeast Asia and China as the yen revalued after 1985.

Japanese producers, to be sure, are not the only or in most cases the principal cause of rising American trade deficits with other parts of Asia. Korean, Taiwanese, and American producers, drawn by low labor costs and often by productive efficiency, have also been drawn to the same offshore production sites. Much of the production of all these multinational firms is for local markets. But the fact remains that the U.S. market is the largest, the most open, and generally the most lucrative, for producers of all nations. As a result, Southeast Asian nations and China, in particular, have become export platforms for the multinationals of many nations, compounding the U.S. trade deficit.

The shift from exports to investment within East Asia also has a major security implication: the new exporters of capital, with large and rising assets at risk beyond their borders, gain

important new stakes in regional political stability. This pressing new interest in Asian regional security is most tangibly and keenly felt by Japan. Its direct investment in the rest of Asia has more than tripled in less than a decade to over \$65 billion. Japan has more than \$15 billion invested in Indonesia alone.

Japan's security concerns in Asia, of course, are especially acute, both because of that nation's major economic stakes in the region and its constitutionally constrained military posture. Its role as a large-scale, lightly armed creditor nation is virtually unprecedented in history, although Holland and Venice provide partial analogies. This role has become especially anomalous since 1985, as Japan's investment stake in a sometimes-turbulent Asia has steadily continually continued to rise.

Expanding Economic Ties Across Cold War Boundaries

Across the 1960s and 1970s economic integration among Japan, South Korea, Taiwan, and ASEAN proceeded rapidly, reinforcing America's security relationships of the period. China, North Korea, the Russian Far East, and the Communist portions of Vietnam had much more distant ties, generally speaking, with non-Communist Asia. They remained largely outside its dynamic orbit of rising prosperity, with poor infrastructure, poor communications, under-developed resources, and low rates of economic growth.

Matters have changed rapidly since 1992, with important economic and security implications that remain yet dimly

perceived in the United States. Most importantly, foreign investment in China and Vietnam has soared, sharply accelerating economic growth, fueling inflation, and creating important new economic links spanning the tortured old Cold War divides. The Russian Far East has also slowly been brought into the global economic system, with projects such as the massive "Four M" energy development venture in Sakhalin likely to fuel this process still further. Only North Korea, with its ambiguous nuclear policies, remains largely beyond the broadening orbit of economic integration.

The economic implications of this broadening East Asian regional integration are clear: accelerated growth, coupled with chronic infrastructural difficulties in transport, power, and communications. These make inflation and shortages chronic and recurring difficulties.

The security implications are more complex and ambiguous. Hyper-growth in China has doubtless fueled its national aspirations and military potential. The same may also be true of Vietnam, to some degree. Yet the erosion of Cold War boundaries has also encouraged centrifugal tendencies that are also constraining and complicating the expansion of national military strength.

The New Energy Equation

Since the dual Oil Shocks of the 1970s, the world has not thought much about energy. The time has come for revising this apathetic view. As a consequence of high growth, many Asian

nations that have always been energy-short, such as Japan, Korea, and Thailand, are growing more so. And others like Indonesia and China, that once supplied the rest of the region, are turning from surplus to deficit. The net result is that Asia as a whole is growing rapidly more dependent on the low global producer--the volatile Middle East.

By the year 2010, by recent forecasts, East Asia as a whole will be importing at least three million barrels of crude oil a day, or half the production of Saudi Arabia. And 95 percent of these imports will be flowing from the Middle East. China alone, a significant oil exporter until late 1993, could alone be importing three million barrels a day, or the entire net imports of the region.

Within Asia itself, the structure of imports is also rapidly shifting. In 1992 Japan came close to monopolizing regional oil imports, with almost 70 percent of the total. Within fifteen years, according to recent APEC projections, Japan's share will have declined to under 40 percent. By 2010, it will be joined in regional oil markets by three other major claimants: Korea, China, and ASEAN, with roughly 20 percent of the import market apiece. In a tight seller's market for energy, a balance of power struggle for Middle East oil could well emerge.

The economic implications of such prospective developments are troubling: potentially higher oil prices and inflation; a looming Oil Shock that revives OPEC, triggered by surging Asian oil demand; and magnified importance for offshore reserves in the

South and East China Sea. The more buoyant the prognosis for East Asian growth, the more troubling these energy scenarios become. The security implications, in the absence of a stable American presence, are even more explosive: deepening national rivalries over energy; a possible naval arms race to control lanes of supply to the Persian Gulf; and conflict over the disputed oil reserves of the East and South China Seas, with China and Japan as potential adversaries.

Reduced Economic Reliance on the United States

For more than forty years, until around 1990, non-Communist Asia was profoundly dependent on America for export markets and investment capital. Most longstanding links from the past, including well over \$200 billion in cross-investment, still remain, while trans-Pacific ties in a few areas, such as advanced technology flows, are arguably deepening. Yet the relative economic dependence on America of almost all Asian nations has either stagnated or weakened since 1990, with major implications for both economics and security.

The loosening of trans-Pacific economic ties can be seen strikingly in the case of Japan. In 1988 almost 40 percent of Japanese exports went to the U.S., together with well over half of Japan's rapidly rising foreign investment. Since 1991, however, Japanese trade with Asia has been larger than that with the U.S.--in 1994 almost 15 percent larger. Many Japanese investments of the 1980s in this country, like Rockefeller

Center, have fallen on hard times, and 90 percent of the profits that Japanese multinationals now make flow from within East Asia.

The buoyance of China's--and indeed, most of Asia's, economic expansion since the early 1990s--helps to explain the rising regionalization of trade and investment. Deepening corporate ties are also a factor. With Japan's economy likely to resume its expansion by mid-1996, and with many Japanese offshore suppliers in Asia now well established, the next few years could lead Japan and Asia even closer economically, as ties with the U.S. decline in relative terms.

In the calculus of economic affairs alone Western Pacific regionalism has no particular adverse implications, unless flowing from discriminatory trading practices. But in geostrategic terms it could be dangerous. Exclusivist economic regionalism within Asia could seriously erode the political rationale here in the United States for American forward deployments in the Pacific, including those in Korea and Japan. This nation and the world both need a strong American business presence in Asia, to justify politically our extensive security commitments there.

In Conclusion: A New Paradigm and New Imperatives

The emerging East Asia could well be a politically fluid region of multiple economic and political power centers. It will also most probably be an area of continued rapid economic growth. The important economic changes that have transpired there since

1985--rapid Asian growth, lessened dependence on America, and broadened Asian political-economic options, in particular-- suggest this prognosis of affluence and volatility. New American strategies will be needed to respond to a clearly transformed environment that will offer a sharply heightened measure of both risk and reward for the United States.

In thinking about American strategies for Asia, we cannot forget that, amidst all the ongoing change in that region, a few enduring, if unpleasant, realities persist. At the top of the list, of course, is the intractable American trade deficit with Asia, now well over \$100 billion annually. This is rapidly broadening beyond Japan, both through the offshore activities of Japanese multinationals newly invested in Asia, and the exports of other firms also.

A second continuing reality is the disappointing level of foreign imports into Japan. This is important not only because it perpetuates U.S.-Japan bilateral imbalances and trade frictions, but also due to its impact on long-term economic growth and political stability throughout the Pacific as a whole. Japan is the only nation in the Pacific, at this stage, with the economic scale to supplant the U.S. as the principal locomotive for regional economic growth. That transition will become more and more crucial to regional stability, and to American interests, as accumulated U.S. fiscal and current-account deficits mount.

Japan, to be sure, has been slowly changing, particularly in

its structural ability and psychological willingness to accommodate manufactured imports. More than in previous business cycles, the problem is macroeconomic--the absence of domestic demand within Japan itself. The September 20 Japanese fiscal package should help, although another large supplementary budget may well be required, together with more decisive Japanese action in dealing with the banking crisis. In the longer run, the rapid aging of Japanese society over the next decade, coupled with liberalizing political changes, should gradually reduce Japan's high savings rate, and produce a more consumption-oriented political economy. But sustained trade-policy pressure from the United States, including determined monitoring of existing agreements, will likely be necessary to assure that structural barriers, formal and informal, are overcome.

Emerging trends in the Asian political economy clearly generate important new security imperatives for the United States. These have already been discussed by other witnesses, and are beyond the principal scope of these remarks. Suffice it to say, as Under-Secretary of Defense Joseph Nye and others have repeatedly affirmed, that an active, forward-deployed U.S. security presence in the Western Pacific, based on a stable, cooperative U.S.-Japan security relationship, will be indispensable for the foreseeable future. A solid U.S.-Japan alliance will be important for economic as well as security reasons, in that it can reduce Pacific regional political-risk premiums, and facilitate large-scale, capital-intensive, and

growth-promoting projects in Asia that might seem infeasible in a fluid balance-of-power world.

The dynamic yet volatile East Asia just now emerging creates a long-term imperative which the Clinton Administration has rightly perceived, to foster multilateral organizations like APEC. Such a body is needed to preempt narrower regionalist trends, and to promote the integration of large, autarkic states like China within a stabilizing international framework. Our trade negotiators are right to stress the value of concrete, long-term liberalization goals, and to oppose attempts to create sectoral exceptions in such areas as agriculture.

As President Bill Clinton prepares to go to Osaka for the APEC Summit, however, he needs to travel with a sense of private realism. The barriers to comprehensive trade liberalization in the Pacific by 2010 are huge, and there is a serious danger that U.S. bargaining leverage may be squandered on sweeping, symbolic, and ultimately unrealistic declarations that will not be honored in future years. Realistically speaking, there will inevitably be substantial sectoral variation in the actual pace of Pacific integration. The U.S. should, accordingly, consider the merits of interim sectoral agreements in key areas of special American interest, including financial and legal services, telecommunications, and so on that could both concretely assist American firms and also further the broader process of Pacific integration. The Administration should also consider the merits of having APEC provide regional public goods, including

infrastructure, specialized APEC research institutes, and so on, in its overall vision of APEC, although not at the cost of the Bogor long-term trade liberalization commitments.

The emerging East Asia creates three additional imperatives for American economic policy. The first is for a more focused policy agenda. As Asia grows less dependent on the U.S., American leverage in that region will inevitably decline, meaning that the U.S. will need to ration its political capital with Asian governments more wisely than it has often done in the past. While we cannot abandon our historic, morally based commitment as a nation to human rights, for example, we need to weigh the utility of specific initiatives in that sphere against security and trade policy concerns.

The second imperative is a need for a clearer American energy policy for the Pacific. As suggested above, the emerging East Asia could grow dangerously short of energy, and much more heavily reliant on the Middle East, with major security as well as economic implications. The Administration has, over the past two years, done a fairly active job of promoting U.S. corporate interests in the energy area, on an ad hoc basis. America needs, however, to think more systematically about how this nation can, either independently or in cooperation with energy-short allies in the region like Japan and Korea, systematically expand Pacific regional energy supplies, and reduce political uncertainties now impeding large-scale energy development there.

A third related imperative in East Asian economic policy is

for stronger, more focused support of U.S. corporate investment activities in Asia, especially of service and support for large-scale infrastructure projects. A vigorous corporate presence in Asia--especially in sectors that add to rather than diminish the vital stock of jobs at home--will be crucial to keeping the U.S. security presence in the Western Pacific politically viable in this country. The trillion-dollar Asian infrastructure market of the next decade provides an excellent opportunity. Among other options, we should consider the possible merits of joint U.S.-Japan or U.S.-Korean projects in third countries, especially those in nations such as Indonesia, where the U.S. commercial presence remains weak compared to the Northeast Asian economic powers. The U.S. should also press more concretely on behalf of U.S. firms for improved access to Japanese ODA support for specific Asian projects, which could provide much larger dividends for U.S. exporters than our often ineffective efforts in Japan itself.

The Asia of the coming decade could present to the United States with both "the best of times and the worst of times." Turbulence amidst rising affluence will be a constant theme across the region. It will be both dangerous, and economically counter-productive, in such circumstances, for America to proceed unwittingly with business as usual.

ROBERT ALAN FELDMAN

Robert Alan Feldman is a Managing Director of Salomon Brothers Asia Ltd (SBAL). As Chief Economist for Japan, he is responsible for forecasting the Japanese economy, along with yen interest rates, bond yields, and exchange rates. He also presents the Salomon world economic view to clients in Japan and the Asia-Pacific Region. For his economics work, Mr. Feldman has been ranked the Number One economist in Japan in global investor surveys by the Nikkei Newspaper, Institutional Investor, and Asia Money. Mr. Feldman is also Co-Head of the SBAL Research Department. In this capacity, he contributes to product development and coordination, performs research supervisory functions, carries out administrative duties, and coordinates Tokyo Research with other Salomon centers.

Prior to joining Salomon in May 1989, Mr. Feldman worked for six years as an economist at the International Monetary Fund, primarily in the Research and European Departments, covering G7 matters and Germany. Earlier, he worked at Chase Manhattan Bank and the Federal Reserve Bank of New York.

Mr. Feldman graduated from Yale in 1976, summa cum laude, with B.A.s in both Economics and Japanese Studies. He took a Ph.D. in Economics at MIT in 1983. His dissertation, partially researched while a Fulbright scholar at the Bank of Japan's Institute of Monetary and Economic Studies, formed the core of his 1986 book, *Japanese Financial Markets: Deficits, Dilemmas, and Deregulation*. He has also contributed chapters to numerous academic and policy-oriented books on Japan, in addition to writing academic articles. Mr. Feldman speaks, reads, and writes Japanese fluently, and has translated four books from Japanese to English. He contributes Japanese-language economics commentary regularly to two Tokyo magazines.

Born in 1953 in Oak Ridge, Tennessee, USA, Mr. Feldman became involved with Japan in 1970, when he spent one year as an AFS exchange student at Nanzan High School, in Nagoya. He has lived in Japan for eight years. He is Married with one son.

Mr. Feldman is a member of the Finance Advisory Committee of Nishimachi School, Tokyo.

Mr. Chairman and Members of the Committee,

It is a great honor to appear before you today, and to be given the opportunity to express my own views about political change in Japan, its effects on the Japanese economy, and potential implications for US-Japan relations. I should explain that I have been involved with Japan for the past 26 years, as both student and economist. I have been in my present job with Salomon since late 1989, and have resided in Tokyo continuously since then. I have frequent contacts with officials from our own government as well as the Japanese government, and in addition with other governments interested in the Japanese economy. Let me stress, however, that the views and analysis I present today are my own.

Symptoms of Change

Japan has undergone a momentous but incomplete change in its political system. The symptoms of this change are easy to see. The Liberal Democratic Party (LDP), which held power for 38 years, was defeated in the 1993 election. That Party only managed to return to power by forging an alliance with the Socialist Party, their arch rival for those 38 years. The districting system for the Lower House of the Diet has been totally overhauled. Political funding from the corporate sector has all but dried up. Maverick politicians have won the governorships of the two largest prefectures, on shoestring budgets. And the LDP was soundly defeated in the July Upper House election this year.

The Causes of Change

The main cause of these changes has been, in my view, the change of voter attitudes in the wake of the end of the cold war. To put it bluntly, the Japanese electorate put up with the corruption and undemocratic nature of the post-war political system in return for the security that the U.S. Japan alliance brought. Since the Socialist Party rejected the notion of that alliance, the electorate was left with little choice. When the Soviet Union fell, however, the calculus of consent changed.

Another key factor was the realization on the part of politicians that the incentives built into the old system essentially forced them into gray area activity. Raising the money needed for campaigns forced virtually every politician to join a faction within his own party. These factions were not associations of like-minded legislators, but rather a convenience for channeling funds. Some politicians developed a comparative advantage in fund raising. However, without clear rules on what was and what was not acceptable in funding solicitations, these specialized politicians became increasingly fearful of being pilloried for seeking the funds that the system required them to gather. And their personal secretaries were often in even more danger. There have been a number of cases over the years of

political secretaries committing suicide in order to prevent embarrassment to the politicians they worked for. While the faction system was efficient as for raising and channeling funds, the costs of this system grew over time. Politicians themselves saw the need for reform.

Yet another concern was a genuine worry about a decline of democratic spirit. Voter turnout ratios have been on the decline for some time. The more scandals, the more voter participation declined. Because of the nature of Japanese society, in which individuals tend to follow those who take power, this decline of voter participation worried those who feared that the wrong sort of people might again seize the reigns of power as they did in the 1930s.

On top of these factors was the bursting of the economic bubble and the subsequent drop of corporate profits -- the seed money for political contributions. Just as corporations have been forced to go through painful restructuring, including cost cutting, labor cuts, and the breaking and reforming of strategic alliances, so the political world was forced to do the same. When there is no money for investment, politics too must be cheaper.

The Form of Reform

These forces have led to two major results so far, the change of the districting system for the Lower House and the change of campaign funding laws.

The reform of the districting system for the Lower House has two important aspects. One is a shift of representation toward a fairer allocation from rural to urban districts. Under the old system, the rural regions of the country that will lose representation had 48% of the Diet seats, but under the new system these regions will have only 42%. Conversely, the urban regions that will gain had 52% under the old system but 58% under the new system. That is, a 48-52% margin will turn into a 42%-58% chasm. The purpose of this change was to make representation more democratic, and hopefully reduce the degree of political apathy.

The second aspect of the new district system is a change from multi-member districts under the old system to a combination of single member districts for 3/5 of the seats and the remaining seats selected by party lists from party lists in eleven regional districts. The purpose of this change was to make the final composition of the Diet more reflective of party support, and to reduce corruption. The latter goal followed from the tendency under the old system for many candidates from the same party to run against each other, thus raising costs and increasing the incentive for questionable fund-raising activities.

While changes in the district system were the focus of debate, changes in the campaign financing law were also important. These changes

significantly increased the amount of disclosure of political funding sources, reduced the numbers of channels through which funds could flow to any individual politician, concentrated funding power in the hands of the party apparatus, and introduced public funding of political parties. These changes appear to have been quite effective, as seen in the collapse of the factional structure in the LDP. Indeed, one politician in a recent speech indignantly said that corporations were using the new campaign funding laws as an excuse to avoid political contributions.

Results of Reform

The results of these reforms are still far from apparent. However, there has been -- in my judgement -- a distinct change in two of the qualities of Japanese political life. First, policy differences appear to be much more important in both debate and in determining the outcome of elections. The initial break-up of the political parties in June, 1993 was essentially due to the presentation of a clear political platform by Morihiro Hosokawa. He was rewarded for his boldness -- and for the rejuvenation of politics that he brought -- with the Prime Ministership. To the extent possible in a fragmented coalition, he pushed his agenda of deregulation and federalism. More recently, the governorship of Tokyo prefecture was won by now Governor Aoshima, who campaigned on a policy platform -- no bailout of corrupt S&Ls and canceling what he saw as a very large, very wasteful Tokyo International Exhibition. He won overwhelmingly. In addition, the opposition New Frontier Party (NFP) won a solid victory over the LDP in the Upper House elections in July. Some attribute this to the strong organizational ability of one components that formed the NFP. But it is hard to believe that the LDP all of a sudden lost its own organizational abilities. In addition, the policy platforms of the coalition and the NFP have attracted wide attention, and are very specific and contrasting in many respects. For the first time in many years, policy matters in national elections.

A second element of reform is that politicians have become far more risk averse about taking the policy debate to the public for resolution. This paralysis results from the confluence of three factors. They do not know what the public wants. They are not used to campaigning on specific policies. And they do not know how the new election system will operate in practice. Hence, despite constant noises from within the ruling coalition about going to the voters, about forming new parties, and about policy disagreements, reasons have always been found for sticking together. Further election victories by the opposition would likely deepen the paralysis of the ruling coalition. The coalition's strategy now seems to be to spend a lot of money on construction projects and on yet more payoffs to farmers, hope people feel better in a few months, and, if they do, call an election.

Much of course could go wrong with the coalition's plan. In fact, any serious disruption in foreign policy or renewed failure in economic policy

could precipitate a general election. When discussing these matters with my clients, I warn them to be prepared for an election at any time.

How to Read the Upcoming Election

While it is impossible to predict the exact outcome of the next general election, it is possible to provide a framework for analyzing the results. This framework derives from a classification of politicians along the two major philosophical fault lines. The first fault line concerns economic philosophy, and contrasts dirigists (who emphasize heavy government involvement in economic activity) with laissez-faires (who want small, non-intrusive government). The second fault line concerns foreign policy philosophy, and contrasts the hawks (who favor active participation of Japan in global initiatives and energetic defense of Japanese interests) with doves (who wish Japan to avoid engagement in external commitments). There is no necessary correlation between the philosophies -- at least in the Japanese mind.

These two aspects of political philosophy allow four combinations, all of which are well populated by Japanese politicians. The first is the Dirigist-Hawks. This group constitutes the old order, and is best represented by the new President of the LDP, Mr. Hashimoto. While claiming to favor deregulation, his recent debate appearances made it clear that he wishes to achieve consensus with the bureaucracy before steps are taken. This attitude virtually guarantees a go-slow approach in deregulation.

The second group is the Dirigist-Doves. These are best represented by Prime Minister Murayama. The economic philosophy of the Socialist Party has been interventionist throughout its history, and none of the recent changes in Party policy has altered this approach. Moreover, while major changes have been made in the Party's foreign policy stance -- such as recognizing the constitutionality of the Self Defense Force -- the Party remains cautious on most foreign policy initiatives that would take risks.

The third group is the Laissez-Faire Hawks. These are best represented by Ichiro Ozawa, now Party Secretary of the NFP. He has advocated a thorough deregulation of the economy, while also retaining his advocacy of active Japanese engagement in world affairs. He was, as many will remember, one of the most energetic advocates of Japanese support for the Allied cause in the Gulf War -- and indeed expended a great deal of political capital at great cost to himself in order to win the day for that advocacy.

The fourth group is the Laissez-Faire Doves. These are best represented by Finance Minister Takemura. His small party, the Sakigake party -- which has skillfully remained part of government since the Hosokawa Revolution -- maintains a bias toward deregulation. Still, Takemura has taken an extremely strong position on so-called peace issues, such as opposition to nuclear testing.

Complications

While this taxonomy is helpful, there are some serious problems in using it as a crystal ball. First, as mentioned earlier, many politicians are reluctant to clarify their positions on issues, even though the voters demand for such clarification has increased. It is not clear that any of the major parties will present the voters with a clear choice. Indeed, any assignment of politicians to quadrants must be impressionistic. The politicians to whom I have shown this classification system react indignantly at the thought of being cubby-holed so simply. They seem to believe that there are many more axes needed in the taxonomy. Moreover, politicians may be on one part of the spectrum on one issue but another part on a different issue.

Second, it is far from clear where the voters themselves stand. More than 50% of surveyed voters in many opinion polls support no political party. And since the parties do not have clear stances on many issues, it is impossible to read voter philosophies from party support rates.

Third, it is far from clear how the new electoral system will translate voter preferences into Diet seats.

The difficulty of identifying the location of politicians on the philosophy map, and of locating voter blocs on the same map suggests an interesting possibility: What if the voters are all in one quadrant (e.g. the *Laissez-Faire* Dove quadrant) but the politicians are all in other quadrants? This is not idle speculation. Some political analysts explain the surly mood of the American electorate by saying that politicians are moving to the extremes while the populace is moving to the center.

Despite all of this uncertainty, one can make relatively clear statements about the types of economic policies that will emerge from the election. This is possible because the potential coalitions among the quadrants are narrowing.

Potential Coalitions and Their Likely Economic Policies

Political polls currently suggest three possible outcomes to the upcoming general election. The underlying philosophies of the resultant governments do allow us to make some general but meaningful statements about potential patterns of growth and price movements.

The first possible outcome is an outright victory by the LDP. Despite recent election setbacks, there is a substantial element in the LDP that believes in this scenario. The November 19 by-election in Saga prefecture, which is shaping up to be a one-on-one fight between the LDP and the NFP, could affect judgement on the likelihood of a national victory by the

LDP. The economic outcome of an outright LDP victory is likely to be a mix of aggressive demand support policies and timid deregulation. The character of LDP politics has typically emphasized spending on two activities, public works and agriculture. In this sense, the most recent economic support package was an archetypal LDP package. There was much spending in these two areas, and virtually nothing new in the area of deregulation. Such a policy orientation for the new government would lead to large increases in demand but little improvement in supply and relatively little decline in Japan's trade surpluses. Growth would rise, but constrained supply would eventually bring prices up too.

The second possible election outcome is the so-called double conservative alliance. This would be a coalition between the Dirigist Hawks and the Laissez-Faire Hawks. Such a coalition might be hard to arrange, in light of the bad blood between these two camps. However, it would be less bizarre than the current alliance between the Socialists and the LDP. In the economic policy realm, fiscal policy would remain stimulative, although the composition of spending would likely be tilted somewhat more toward tax cuts and welfare spending for the urban constituency that supports the Laissez-Faire Hawks. Deregulation policy would be somewhat more aggressive, as those in the LDP such as Yohei Kono, who advocate more deregulation, would now have powerful allies for their own policy agenda. Growth would rise, probably somewhat more than in the first scenario, and supply would likely be less constrained, leading to less inflation. Trade surpluses would probably come down somewhat faster.

The third possible outcome is the so-called reformist alliance. This would be a coalition of the Laissez-Faire Hawks and the Laissez-Faire Doves. In this case, a muddled solution of foreign policy issues would result, but the economic implications would be clear. Fiscal policy would focus on tax cuts and welfare spending for the urban constituency, and deregulation would be aggressive. Growth would rise further, and prices would remain stable -- and perhaps fall even further -- as resources were reallocated toward more efficient uses. This would be what I call supply side deflation, that is a desirable decline of prices generated by rapid productivity growth.

The Japanese Economy in 1996

At present, the Japanese economy in 1996 appears most likely to follow either the first or second of these scenarios, that is a substantial pick up of growth, with a switch from modest deflation to modest price increases. The Salomon Brothers forecast for fiscal 1996 is for GDP growth of 2.8%, and inflation of 0.5%, up from 0.4% and -0.5% respectively for the current fiscal year. For more details on this outlook, please refer to our recent research piece, "The Easy Part is Done".

Japanese Hawks Help America

How will US-Japan relations fare under each of these political scenarios? Let me first be explicit about what Japanese policies will serve US interests.

In the foreign policy realm, I believe that a hawkish Japanese stance will best serve the interests of the US. There are two reasons for this view. First, the so-called hawks are not hawks in the sense of being "nationalists" as practiced in the 1930s. Rather, they wish Japan to play an active role in helping solve the world's very pressing problems such as population control, environmental degradation, poverty, disease, and war. Their opponents are not so much doves as ostriches. These so-called doves seek to avoid problems that simply cannot be avoided. Just as in the fight against fascism in our parents generation and against communism in our generation, the fight against today's global problems is too big for America to handle alone. We need help. Japan is one of the few countries that has the economic and technological power to help us in this struggle.

There is a second, and somewhat ironic reason that a hawkish Japanese foreign policy stance helps the United States. The starting point is a healthy skepticism about the nature of our own democracy. After all, our own founding fathers designed our system of government as one of checks and balances. As members of Congress, you are probably far more aware than I of the tendency for constituents to try to feed at the public trough. Indeed, I. M. Destler's superb book on US trade policy suggests that Congress created USTR not to "protect" the US from foreign competition but to protect Congress from greedy constituents. A hawkish Japanese foreign policy can serve a similar function. If Japan were to play doormat, special interests in our own country would be more likely to capture the political process and distort our economy. The reverse is also true of course. But it is important to realize that we are better off with a forthright stand by Japan against attempts by American special interest groups to distort our own economy, even if we fail in our attempts to prevent (or lessen) Japan's distortion of its own economy.

Let me add one more point on the dynamics of hawks in country A helping defeat distortionary special interests in country B. The key element here is, in my opinion, moral authority. Large, diffuse interests can only succeed against small, concentrated ones through the power of ideas. For the hawks in country A to defeat special interests in country B, the general interest in country B must be galvanized. It is hard to galvanize public opinion, especially from abroad, when the foreign force fails to practice what it preaches. St. Francis once said that one should preach the gospel at all times, and use words if necessary. His point was that the best pedagogy is example.

To be more concrete: If Japan wants the US to behave differently in semiconductor agreements, auto parts agreements, dairy protection, sugar protection, light truck tariffs, dumping duty formulas, or the host of other

-- often valid -- criticisms of US trade policies, the best way to achieve this result is by dismantling its own trade barriers. And if the US wants Japan to behave differently, the best course of action is to clean up our own act, not only in trade policy but also in social policy. For example, a few years ago, a 16 year old Japanese exchange student was murdered on Halloween night, and his murderers suffered no penalties for this crime. I met the student's father a few weeks ago. It was a difficult to suppress tears -- not only of sadness but of shame. Could any member of this committee look that father in the eye and call America just? The Japanese people, whose support we need in our common quest, will never trust the US fully as long as we leave murder unpunished.

Deregulation: The Hope for World Prosperity

A more aggressive deregulation by Japan is also in the US's interest, again for several reasons. The first is obvious, greater access for US goods in Japanese markets. As a consumer living in Japan, I can testify to the tremendous improvements in the past few years from improved market access. Let me give but one example: My wife ordered a sweater from an American mail order house last autumn. While hiking a few months later, we met a Japanese woman in her 60s on the trail. She was wearing exactly the same sweater. I asked her if she had bought it from LL Bean. She said, "I forget. Either there or Land's End." While just a vignette, this story shows that Japanese are eager to buy good stuff cheap. The continued and strong growth of import volume despite a four year recession demonstrates that deregulation does help US commercial interests in Japan.

Equally important, however, are the benefits to the US from more efficient resource allocation in Japan. So long as deregulation remains slow, the ability of Japan to reallocate resources to their most efficient uses will be hindered. Why? Because the price signals necessary to foster efficient resource allocation are absent. How will data transmission services grow efficiently if the cost of transmission is six times the level in the United States? How can land be used efficiently when the entire transportation system is subject to centrally sanctioned fare structures that protect vested interests? Excessive regulation is causing resource misallocations that constrain Japanese growth. And the US -- along with every other country in the world -- is a loser.

In addition, the lack of deregulation has raised the value of the yen. While good for some US export interests, a strong yen raises costs of buying Japanese goods. To the extent that the ever-rising yen has scared Japanese investors from recycling surpluses to the United States, the lack of deregulation has also raised the cost of capital to our country and the rest of the world.

This analysis suggests that there is good news for US-Japan relations under all three of the most likely political outcomes in Japan. Under two of the outcomes, a more internationally energetic Japan will emerge. And, in two of the scenarios, a more aggressive approach to deregulation will emerge. That's not bad.

However, the dark side of this analysis is that there will also be frustrations under all scenarios. Under two, there is insufficient deregulation. And under one there is serious risk of Japan taking a limp foreign policy stance. This would hinder our common agenda, and invite special interests at home to hijack US policy.

There are two key points for US policy. The first is to identify and encourage the forces in Japan that will take an energetic stance on global issues and an aggressive stance on deregulation. The second is to preach our own gospel, without words.

Thank you.

BIOGRAPHICAL SKETCH

Leonard Schoppa is an assistant professor in the Department of Government and Foreign Affairs at the University of Virginia where he teaches courses in Japanese politics and foreign relations. He received his D.Phil in politics from Oxford University in 1989 and is a graduate of Georgetown University. His first book, Education Reform in Japan, looked at sources of immobilism in the Japanese policymaking process. His second book, Bargaining With Japan: What American Pressure Can and Cannot Do, is forthcoming from Columbia University Press. The book examines the record of the Bush administration's Structural Impediments Initiative and the Clinton administration's Framework talks and argues the U.S. pressure is most effective when it works synergistically with politics inside Japan.

TESTIMONY OF
LEONARD SCHOPPA
ASSISTANT PROFESSOR
DEPARTMENT OF GOVERNMENT AND FOREIGN AFFAIRS
UNIVERSITY OF VIRGINIA
BEFORE THE HOUSE COMMITTEE ON
INTERNATIONAL RELATIONS
SUBCOMMITTEE ON ASIA AND THE PACIFIC
OCTOBER 30, 1995

Mr. Chairman and members of the Subcommittee:

I am pleased to have this opportunity to testify before your subcommittee on the implications of recent developments in Japanese politics for American interests. As you know, there have been many changes in Japanese politics over the past two years. First, the long-ruling Liberal Democratic Party (LDP) was tossed out of power for the first time in 38 years in the summer of 1993, replaced by a series of weak and unstable coalition governments. Second, the government adopted last fall a set of electoral and political finance reforms which were designed to dramatically change the incentive structure confronting Japanese politicians. Finally, Japanese politics has been affected by the end of the Cold War, a shock to the system which has led many Japanese to take a critical look at foreign policy patterns which they took for granted for so many years.

All of these changes have implications for America's interests in its relations with Japan. While the changes have implications for U.S.-Japan security relations as well, today I would like to focus my remarks on what they mean for the future of our bilateral economic relationship. In the short term, I will argue, all three of these recent developments have adversely affected the ability of the United States to extract trade concessions from the Japanese in the manner to which we have grown accustomed over the past few decades. These difficulties were revealed in dramatic fashion this past summer, I propose, in the failure of the administration to extract the kind of "results-oriented" trade deal it said it wanted from Japan on access to the Japanese auto and auto parts markets. In the longer term, however, the changes open up opportunities for the U.S. to help open up the Japanese market.

Before looking at the recent changes in Japanese politics, I think it is important to pause and recognize how unusually effective American trade pressure has been over the past 20 years or so. Table 10.1 and Figure 10.1, based on data presented in an Institute for International Economics study by Thomas Bayard and Kimberly Elliott, show clearly how Japan has been an "outlier" in terms of its responsiveness to U.S. pressure. Of those countries frequently targeted under Section 301 of U.S. trade law, cases involving Japan on average yielded the most "success." While cases targeting Europe and Canada averaged a "1" on the responsiveness scale--meaning the average deal turned out to be only a "nominal success,"

cases involving Japan were on average a "2.1"--better than "partially successful." Japan's responsiveness is striking especially when you consider that it was more responsive than Taiwan, Canada, and South Korea--all of which depend on exports to the U.S. for a greater share of their GDP.

These data suggest that America's success in using trade pressure to extract concessions from Japan may have rested on some special circumstances--circumstances that have changed, I propose, over the past two years. First, our success rested on habits and attitudes formed during the Cold War. Even as Japan grew in its economic power, the nation's officials (and even its politicians) continued to be content to play "junior partner" to America's "senior partner" partly because these elites matured and served during a period in which Japan's alliance with the U.S. was its only mooring in a hostile world. The deference bred into Japanese officials during this period made them more likely to give in to U.S. pressure than their counterparts in, say, France. Equally important, Japanese trade negotiators could give up more on sensitive issues because they could always sell the sacrifice to the affected Japanese constituencies with the argument that it was necessary in view of Japan's dependence on the American security blanket.

While it took a few years after Gorbachev's arrival before Japanese elites recognized that the Cold War was finally over, the realization that Japan is no longer dependent on the U.S. to shield it from the Red Menace has affected attitudes toward the U.S. very quickly. One hears and reads the term "post-Cold War world" everywhere in Tokyo these days, so much that it has been used to rationalize a whole range of foreign policy proposals. The feeling that this change means Japan can now "stand up" to the U.S. and be more of a "normal country," however, seems to be particularly widespread. As Paul Blustein of the Post reported in May, this new attitude seems especially pronounced among younger officials in agencies like the Ministry of International Trade and Industry (MITI). These officials are no longer inclined to give in to the U.S. out of deference. They also have a harder time selling Japanese constituents on the need for sacrifice in the name of the U.S.-Japan alliance when it is no longer clear what purpose the U.S. military forces in Japan serve. Telling farmers you have to give up more because "we need the Americans as a cap in our bottle" is a harder sell than the old argument about needing the U.S. to hold off the Soviets.

The effectiveness of U.S. pressure was also served, however, by the way this pressure became, over the course of the LDP's long rule, a sort of "necessary evil" which was vital to the smooth functioning of the system. Partly because the LDP, as the only game in town, represented all of the special interest groups with a stake in the status quo, and partly because the old electoral system created strong incentives for politicians to cater to vested interests that could deliver organized groups of personal votes, policy tended to change very slowly in Japan under the LDP unless there was a "crisis." Inefficient protection of the agricultural market, irrational regulations which gave existing retailers a veto over whether new large stores could open in their territory, and unfair tax codes which allowed wealthy urban farmland owners to escape taxation on multi-million dollar plots of land could not be touched--unless these policies became subject to enough foreign pressure that a "crisis" could be declared so that the policies

could be reformed.

Special interests and government officials favoring change knew that U.S. pressure (or gaiatsu) was the key to breaking the deadlock on many issues. LDP officials too didn't mind blaming politically-difficult decisions on the Americans. Over time, the LDP regime came to depend on gaiatsu much as an addict depends on a drug--to borrow Glen Fukushima's analogy. And to facilitate the process we developed a real routine: we would approach Japanese bureaucrats with a concern, they would protest that demands were unacceptable, the press would declare that U.S.-Japan relations were nearing a breaking point, senior LDP leaders would step in to mediate the dispute, and a "partially successful" agreement would be reached.

Domestic political developments since the summer of 1993 have disrupted this routine. With the LDP thrown out of power, we had to deal with a situation, during the first year of the Framework talks, where the usual suspects we called upon when our talks with the bureaucrats reached an impasse were not available to mediate. Furthermore, the familiar faces that remained such as that of Ozawa Ichiro, the LDP defector who was the power behind the Hosokawa government, were too preoccupied with "political reform" to have any time or energy to devote to bilateral relations. Then, when we thought we had finally found some politicians we could work with in the Hosokawa/Hata/Ozawa camp and restarted the Framework talks in May of 1994, the entire crew was replaced by the motley coalition of the Socialists, LDP, and Sakigake which is still struggling to hold itself together today.

One reason the Framework talks were postponed so many times and produced so little was because all of this political turmoil disrupted the nice routine which had developed during the LDP's long period of rule. It would be a mistake, however, to dismiss our difficulties during the Framework as a passing phase which--some might hope--will give way to a reassertion of old patterns once the LDP (or some other party) regains a stable hold on power. What we need to recognize is that the end of continuous rule by the LDP has made gaiatsu much less of a "necessary evil" for Japan. Advocates of change within the bureaucracy and among interest groups now have an alternative to the United States. They can go to the opposition party: the New Frontier Party (the party formed by the Hosokawa/Hata/Ozawa group). Now that there is a domestic option, gaiatsu is seen as less necessary and so has become less legitimate.

Gaiatsu is also seen as less necessary now that the Japanese have adopted far-reaching electoral and political finance reforms. Ozawa had advocated these reforms as a means of helping Japan wean itself of dependence on gaiatsu and other "irresponsible" aspects of the old regime. The new electoral rules, featuring a mix of single member districts and proportional representation seats instead of the old multi-member districts, remove old incentives for politicians to concentrate their efforts on the task of winning personal votes. By removing this incentive, which led many LDP politicians to organize expensive personal support organizations and to cater to special interests groups that could deliver the cash and votes needed to win under these rules, the reforms are supposed to encourage politicians to campaign for office through programmatic appeals to a much wider segment of the public. No longer

as beholden to interest groups like the farmers, small retailers, and construction firms, politicians will be able to push through policy changes that were impossible to achieve under the old rules--or at least that's the theory.

When and if all of this will actually come to pass is still a matter of heated debate in my profession. We will have to wait and see. In the short term, however, the only thing that has happened is that expectations have been raised by all of this attention to political reform. To the extent some Japanese actually believe the rhetoric and expect (or hope) that Japan will now be able to deal with more of its problems without relying on gaiatsu, they will be less receptive to U.S. attempts to intervene in the old ways. As one Ministry of Foreign Affairs official told me, "the day of gaiatsu has passed. The rice issue was really the last issue where we really needed to use gaiatsu. The rest we can deal with on our own." With Japanese officials adopting such positions, it should come as no surprise that U.S. pressure tactics have been proving much less effective of late.

To recapitulate my argument thus far, all of the recent developments in Japanese politics have served to eliminate the special circumstances which made American trade pressure unusually effective with Japan in the past. What this means is that we should expect Japan to move much closer to the regression line on Figure 10.1. It will act much more like Europe and Canada when we threaten it with unilateral pressure. The lack of results in the auto talks this summer and Japan's more recent refusal to negotiate on the issue of photographic film under the threat of Section 301 are evidence that it has already taken up this new pose.

In the longer term, as I mentioned at the start of my statement, some of the recent changes promise to ease U.S.-Japan trade friction. Most notably, if the new electoral and political finance rules affect politics in the way they were advertised, Japanese politicians will have greater incentives to push for trade liberalization than in the past. Barriers to trade and regulations that limit market competition generate inefficiencies which provide rents to special interests while imposing diffuse costs on consumers. In the past, Japanese electoral rules created unusually strong incentives for politicians to represent the interests of those getting the rents. The new system is supposed to provide them with more of an incentive to represent the consumers who have to pay the costs. It should lead more politicians to call for meaningful deregulation and trade liberalization.

As I noted above, however, none of this is really happening yet. At this point, all we have from politicians is a lot of talk about deregulation without evidence that they are going to fight the bureaucrats and special interests to produce real policy change. Perhaps after a few elections under the new rules, some political entrepreneur will come along and see the opportunity offered by the new electoral rules. While this provides us with some hope for the long term, we all know the saying about how "in the long run, we are all dead." In the short term, the U.S. cannot sit idle and ignore continuing barriers to trade in the Japanese market. The fact that changes in domestic politics mean that the old ways of pressuring Japan are going to be less effective means, however, that we need to find ways in which to continue up the pressure.

While the end of the Cold War has diminished the ability of the U.S. to pressure Japan on its own, it has increased the legitimacy of international organizations like the World Trade Organization. Japanese officials told us repeatedly during the auto talks that these matters should be addressed within the WTO. We should call their bluff, taking advantage of the new dispute settlement mechanism wherever possible. Second, we should look for barriers in Japan which impose high costs on Japanese firms and/or consumers as in the case of the Large Store Law targeted during the SII talks. Instead of attacking these barriers solely with threats of retaliation, as did the Clinton administration, we should make more of a PR effort to educate and mobilize those in Japan who pay the costs of protection. We should also emphasize the potential deregulation has to generate economic growth by eliminating inefficiencies--an argument with immense appeal after three years of recession in Japan. Over time, we might help create the atmosphere which will motivate politicians to take up our cause and work for liberalization without gaiatsu.

Table 10.1
OUTCOMES OF U.S. PRESSURE AS EVALUATED BY BAYARD & ELLIOTT

Cases Involving <u>Japan</u>	Degree to Which U.S. Objective Achieved
Thrown silk (1977-78)	Largely successful
Leather (1977-85)	Partially successful
Cigars (1979-81)	Nominally successful
Pipe tobacco (1979-81)	Nominally successful
Semiconductors (1985-91)	Nominally successful
Cigarettes (1985-86)	Largely successful
Citrus (1988)	Largely successful
Construction (1988-91)	Partially successful
Satellites (1989-90)	Largely successful
Supercomputers (1989-90)	Partially successful
Wood products (1989-90)	Partially successful
Cases Involving <u>E.C.</u>	Degree to Which U.S. Objective Achieved
Egg albumin (1975-80)	Partially successful
Canned fruits and vegetables (1975-79)	Nominally successful
Malt (1975-80)	Not at all successful
Wheat flour (1975-83)	Not at all successful
Canned fruit (1976-80)	Nominally successful
Soybeans and soy meal (1976-79)	Nominally successful
Citrus (1976-86)	Partially successful
Wheat (1978-80)	Nominally successful
Sugar (1981-82)	Not at all successful
Poultry (1981-84)	Nominally successful
Pasta (1981-87)	Partially successful
Canned fruit and raisins (1981-85)	Nominally successful
Corn, sorghum, oilseeds (1986-87)	Largely successful
Meatpacking (1987-88)	Nominally successful
Beef (1987-89)	Not at all successful
Soybeans (1987-90)	Nominally successful
Fabricated copper (1988-90)	Largely successful
Canned fruit (1989)	Partially successful
Corn, sorghum, oilseeds (1990)	Partially successful
Meatpacking (1990-93)	Nominally successful
Cases Involving <u>Canada</u>	Degree to Which U.S. Objective Achieved
Eggs (1975-76)	Largely successful
Broadcasting (1978-84)	Not at all successful
Fish (1986-90)	Partially successful
Beer (1990-93)	Nominally successful

Cases Involving Brazil

Footwear (1982-85)
 Soybean oil and meal (1983-85)
 Informatics (1985-89)
 Pharmaceuticals (1987-90)
 Import licensing (1989-90)
 Intellectual property (1993-94)

**Degree to Which
U.S. Objective Achieved**

Partially successful
 Partially successful
 Partially successful
 Nominally successful
 Largely successful
 Nominally successful

Cases Involving Argentina

Marine insurance (1979-80)
 Leather (1981-82)
 Air couriers (1983-89)
 Soy bean oil and meal (1986-88)
 Pharmaceuticals (1988-89)

**Degree to Which
U.S. Objective Achieved**

Nominally successful
 Not at all successful
 Partially successful
 Partially successful
 Nominally successful

Cases Involving Korea

Insurance (1979-80)
 Footwear (1982-85)
 Insurance (1985-86)
 Intellectual property (1985-86)
 Cigarettes (1988)
 Beef (1988-90)
 Wine (1988-89)

**Degree to Which
U.S. Objective Achieved**

Nominally successful
 Partially successful
 Partially successful
 Nominally successful
 Partially successful
 Partially successful
 Partially successful

Cases Involving Taiwan

Home appliances (1976-77)
 Rice (1983-84)
 Motion picture films (1983-84)
 Customs valuation (1986)
 Beer, wine, tobacco (1986)
 Intellectual property (1992)

**Degree to Which
U.S. Objective Achieved**

Largely successful
 Partially successful
 Partially successful
 Partially successful
 Partially successful
 Nominally successful

Cases Involving India

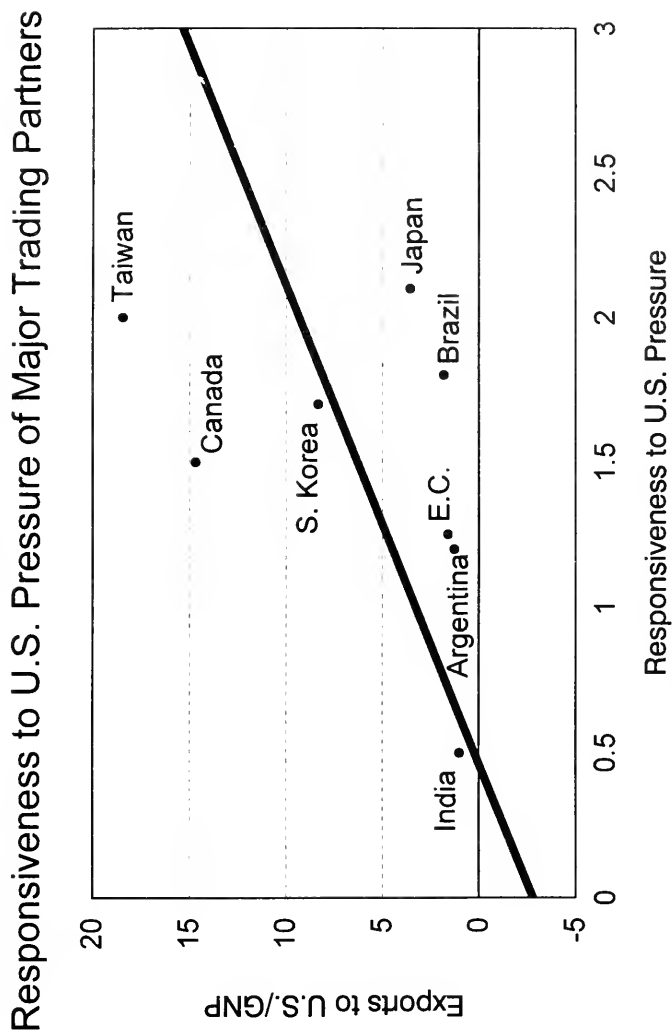
Almonds (1987-88)
 Investment (1989-90)
 Insurance (1989-90)
 Intellectual property (1991-92)

**Degree to Which
U.S. Objective Achieved**

Partially successful
 Not at all successful
 Not at all successful
 Not at all successful

Source: Bayard and Elliott, Reciprocity and Retaliation in U.S. Trade Policy (Institute for International Economics, 1994).

Figure 10.1



Responsiveness Index constructed on scale of 0 to 3 using data in Table 10.1 with "not at all successful" cases weighted as "0" up through "largely successful cases weighted as "3".

MERIT E. JANOW

In the fall of 1994, Merit E. Janow was appointed a Professor in the Practice of International Trade at the School of International and Public Affairs (SIPA) at Columbia University. Prof. Janow teaches graduate courses in foreign economic policy and international trade law at SIPA and Columbia Law School. She is also on the faculty of the East Asian Institute at Columbia University, the Center on Japanese Economy and Business at Columbia Business School, and she co-heads the APEC Studies Center. During the 1993-4 academic year, she was a Senior Research Associate with Columbia's East Asian Institute.

From February 1990 through July 1993, Merit E. Janow was Deputy Assistant U.S. Trade Representative for Japan and China in the Office of the U.S. Trade Representative. Her responsibilities within USTR included the development, coordination and implementation of U.S. trade policy and negotiating strategy toward Japan and the People's Republic of China. Her negotiating areas included: the Structural Impediments Initiative (SII), legal services, satellites, intellectual property rights, market access, paper products, glass products and telecommunication services, among others.

Before joining USTR, Prof. Janow was an associate with the law firm of Skadden, Arps, Slate, Meagher & Flom, specializing in mergers and acquisitions and international corporate transactions. From 1980-1985, she was a member of the professional staff of Hudson Institute, based initially in Tokyo and then in New York. While at Hudson Institute, she conducted policy and economic studies for major U.S. and foreign companies. Prof. Janow also directed a number of studies for the U.S. government.

She is the author of a number of articles and books including: "Private and Public Restraints That Limit Access to Markets", (OECD, forthcoming 1996); "Progress and Discontent in U.S.-Japan Relations", (G. Curtis, ed. W.W. Norton & Co. 1994), Nihon no Kyosoryoku (co-authored, Diamond Press 1989), "Mergers and Acquisitions in Japan: A New Option for Foreign Companies?" Columbia Journal of Transnational Law (1988), The Competition: Dealing with Japan (co-authored, Praeger Publisher 1985), Future Trends on the Korean Peninsula (Hudson Institute 1983), Japanese Industrial Development Policies (1982), among others.

She received a J.D. from Columbia University School of Law, where she was a Stone Scholar and editor of the Columbia Journal of Transnational Law. She is admitted to practice law in the State of New York. She received a B.A. with honors in Asian Studies from the University of Michigan, Ann Arbor. She is a member of the Council on Foreign Relations; the National Committee on U.S.-China Relations, the American Bar Association; and the U.S. National Committee for Pacific Economic Cooperation (U.S.-PECC). Prof. Janow resided in Tokyo for over ten years and speaks and reads Japanese.

POLITICAL AND ECONOMIC DEVELOPMENTS IN JAPAN

Written Statement of
Merit E. Janow¹
Professor in the Practice of International Trade
School of International and Public Affairs
Columbia University, New York
before the
Subcommittee on Asia and the Pacific and
Subcommittee on International Economic Policy and Trade
of the Committee on International Relations
of the U.S. House of Representatives

October 30, 1995

Chairmen, members of the Committees, thank you for inviting me to testify before you today. It is an honor to appear before you to offer some perspectives on recent political and economic developments in Japan and what these suggest for U.S. economic and trade relations with Japan.

Japan is obviously going through an important period of economic and political change. On the economic front, Japan has experienced its longest recession since the recession that followed the second oil crisis. Official growth forecasts have proven overly optimistic and have had to be revised downward. There is widespread uncertainty as to when Japan will regain its growth momentum and at what rate.

In the summer of 1993, the Liberal Democratic Party (LDP)-dominated political system that had characterized Japanese politics since 1955 came to an end. Since then, there have already been three coalition governments and there is considerable confusion about the future configuration of Japanese party politics. Voter turnout is at an all time low (44 percent in the Upper House elections of 1995) and public dissatisfaction with politicians high.

How should we interpret these developments? I would like to start with a few overall conclusions and then discuss how I have come to them.

¹ From 1990-1993, Merit E. Janow was the Deputy Assistant U.S. Trade Representative for Japan and China. Before joining USTR, Merit E. Janow was practicing corporate law in New York. Ms. Janow lived in Japan for more than ten years and speaks and reads Japanese.

- o Japanese politics seems very confused at the present time; it may take several elections before the political situation stabilizes. It is not clear whether the political changes underway will produce a more vigorous policy-centered political process or one that revolves around other more traditional matters such as local organizing skills and skills at mobilizing interest groups.
- o At least until the political situation stabilizes, I expect only modest steps will be undertaken to address the difficult economic issues facing Japan. Trade policy disputes will continue and may even prove more difficult to resolve because the sources of those disputes include not only government policies, but also structural differences and private sector practices which are outside of established trade policy disciplines. Further, at the present time, there appears to be more resistance to U.S. pressure and less political leadership on domestic and international economic issues.
- o I believe that there are important market-driven and demographic changes underway in Japan that over the medium term will cause a further opening and restructuring of the Japanese market. The overall direction of change is clear. The pace of change is more problematic.
- o Economic deregulation is one area where domestic and foreign interests overlap. Deregulation has diverse and widespread support in Japan; it also has powerful opponents. The evolution of Japan's party politics will greatly influence how much deregulation occurs and in what manner. However, there are many cross-pressures on deregulation within Japan. It is important that Japan chose not to solve its economic problems in ways that are inconsistent with a free and open trading system. The U.S. can play a role in encouraging an approach to deregulation that more fully integrates Japan into the global economy. The challenge for U.S. policymakers is to ally with those groups in Japan that are supportive of changes that are in the interests of the United States, Japan and the global economy.

I would like to elaborate on these perspectives.

Japan's Political Economy and Public Attitudes in This Period of Transition

There are three reasons why I believe that we shall see only limited changes in the management and direction of Japan's political economy in the short run.

- o First, during this time of political transition and confusion, there appears to be little desire on the part of Japanese politicians to take on difficult economic issues that could polarize voters.

Japanese politics underwent a dramatic development when the LDP dominance in the Diet came to an end in the summer of 1993. Public dissatisfaction with Japanese politics seemed to be the defining issue and numerous political scandals in the 1970's, 1980's and 1990's had resulted in voter disillusionment and low voter turnout. There was a burst of support when Morihiro Hosokawa and his 7 party coalition took office, and he experienced a 72 percent approval rating when he assumed office--the highest level of support for any Japanese Prime Minister²!

Prime Minister Hosokawa came into office on the issue of political reform and promised to leave office if he did not achieve such reform. By the time he left, his approval rating had dropped to 57 percent³. Hosokawa did succeed in getting through the Diet a compromise political reform bill that introduced a mixed electoral system of 300 single seats and 200 seats from a system of proportional representation. However, his tenure was clouded by obvious difficulties in managing his coalition government, unremitting political infighting and allegations of financial impropriety.

A coalition government headed by Prime Minister Tsutomu Hata succeeded Mr. Hosokawa for a scant few months, soon to be followed by the current three party coalition government headed by Prime Minister Murayama, the first socialist Prime Minister of Japan in 47 years.

Recent polls suggest little support for the Murayama Cabinet. According to a poll conducted on October 13-15 by Nihon Keizai Shimbun, the current cabinet's popularity is at 31%. Some 63.5 percent of the respondents want an entirely new government and the largest single block of respondents, 26.5 percent, want to see a coalition between the LDP and the Shinshinto⁴.

What do these developments suggest for Japanese politics and policies? It does not seem likely that we will get a clear picture of the configuration of Japanese politics until Japan has undergone several elections under the new rules.

At least at the current time, substantive policy issues are not

² See, Yomiuri Shimbun, September 30, 1993.

³ See, Yomiuri Shimbun, April 20, 1994.

⁴ See, Nikkei Weekly, October 23, 1995.

dominating the political process. The major parties, the LDP and the Shinshintō, are both conservative parties. Both are trying to appeal to the same voters and both are gearing up for the first major election under the new rules. In that process, both are stressing very similar (and general) campaign slogans: the need for reform, growth, deregulation and change. What specifically might be done to address Japan's nonperforming loans, a bold timetable on deregulation and other contentious issues do not appear to be the basis by which votes are being garnered.

- o A second and related reason for modest expectations during this time of transition is the absence of public sentiment insisting on the necessity of broad based economic reform.

Voter dissatisfaction with Japanese politicians and bureaucrats may be pronounced but there does not seem to be a pervasive sense of crisis in Japan. According to an August opinion poll conducted by the Prime Minister's Office, 72.7% of the respondents said that they were content with their current standard of living. This survey has been conducted annually by the government since 1958 and the latest survey showed public satisfaction with their current living conditions to be at an all time high⁵.

If this is an accurate window into public attitudes, then one might reasonably question whether or not there is really sufficient public unhappiness with the current state of economic and political affairs to produce the requisite pressures on either politicians or bureaucrats to depart significantly from current practices.

- o Third, at least in the near term, bureaucrats are likely to exert even more than usual control over the policy process.

The reasons for this are severalfold.

Under usual circumstances, bureaucrats exert a high degree of control over policy and the expertise on economic and other policy issues resides primarily in the bureaucracy.

Almost all legislation is drafted by bureaucrats and goes to the Diet through the Cabinet rather than through member bills. Interpellations from the Diet are usually defended by senior bureaucrats.

Political appointees to ministries are very few in number--usually the Minister and the Parliamentary Vice Minister--and Ministers have very little say over personnel decisions within a Ministry. While some Japanese politicians argue that politicians must exert more control over the bureaucracy and become better educated on

⁵ See, Yomiuri Shimbun, August 21, 1995.

policy matters, existing practices show little signs of disappearing anytime soon⁶.

My colleague at Columbia University, Professor Gerald Curtis an expert on Japanese politics who has written extensively on these subjects, argues that the bureaucracy in the U.S. is weaker and control by Congress over policy making stronger than is the case in any parliamentary system. In some ways, Japan is on one end of the spectrum and the United States the other⁷.

Aside from these structural features of the Japanese system, another more immediate reason why bureaucrats appear even more in charge than usual is simply because the attention of politicians appears to be primarily directed at positioning themselves within the parties to increase their chances of getting elected.

Some observers draw the conclusion that politicians in Japan do not really matter because the bureaucrats are really in charge and politicians are mere window dressing. I think this perspective fails to pick up nuances important to Japan's political economy and also important to the resolution of trade dispute between the United States and Japan in the past.

In my experience as a former trade negotiator, bureaucrats in Japan often appear to have difficulties reaching agreement on issues when the proposed policy matter is strongly opposed by domestic private interests or opposed by other bureaucrats. Resolving problems appears especially difficult when issues cut across the jurisdiction of several ministries. In such circumstances, Japanese politicians (including those who are affiliated with such interests) have often played an important role in brokering compromises. This dynamic has been important in trade issues between the United States and Japan but it has arisen in the context of domestic economic policy disputes as well. At this time, when the power base of politicians is in flux, their ability to broker compromises between competing interests appears much reduced.

Pressures for Change in the Japanese Economy

Political and bureaucratic preferences notwithstanding, structural and cyclical pressures on the Japanese economy are causing some

⁶ Ichiro Ozawa, for example, has suggested that government ministries should be infused with politicians and politicians need to assume more responsibility over policymaking. See, Ichiro Ozawa Blueprint for a New Japan, 1994.

⁷ See, Gerald L. Curtis Japanese Politics in Comparative Perspective, August 1995.

changes that are likely to be important in the medium term.

One important source of long term change in Japan will be demographic. According to Japanese government statistics, from 1996 the 15 to 64 age group will begin to decline in absolute terms and from 2010 the overall population will begin to decline⁸. If this projection proves to be accurate, if the economy is to grow, Japanese companies may then have to bring in more foreign workers, move even more operations abroad, hire more women, allow employees to retire later, or shift employment patterns in some other fashion. What is often called in Japan the problems of a "rapidly aging society" will bring a decline in household savings. There will be more government spending on infrastructure for the aged and a decline in the social security account. A number of Japanese and U.S. economists argue that these demographic changes imply a disappearance of Japan's current account surplus within the next ten years, if not sooner⁹.

More immediate pressures on the Japanese economy include the recession and the appreciation of the yen. These market-driven pressures are straining traditional patterns of employment and accentuating distortions within the economy.

The employment adjustment that accompanies recessions in most countries has been fairly limited in Japan relative to the severity and duration of this recession. In 1991, manufacturing output grew by 1.7 percent but manufacturing employment expanded by 2.5 percent. In 1992, manufacturing output declined by a dramatic 6.1 percent but employment continued to grow--albeit at 0.7 percent. In 1993, despite the "end of the recession" according to Japanese Government assessments, manufacturing output declined by 4.5 percent and manufacturing employment declined by 0.8 percent. In 1993, manufacturing output was close to 1988 levels. These drops in industrial production in 1992 and 1993 were the first such back-to-back drops since the 1974-75 first oil crisis, when output declined by 4 percent and 11.1 percent respectively¹⁰.

There was some manufacturing output growth in 1994 and continuing employment adjustment, the former grew at 0.9 percent and the latter declined at 2.1 percent. But so far, in 1995, the industrial production numbers continue to look troubled. Between March and April, industrial production declined 0.9%, dropped an additional

⁸ See, Management and Coordination Agency, Statistical Yearbook 1995.

⁹ Paul R. Masson and Ralph W. Tryon, "macroeconomic Effects of Projected Population Aging in Industrial Countries," IMF Staff Papers, September 1990, pp.473-474.

¹⁰ See, JEI Report No 30A. August 11, 1995

0.5% in May, an additional 0.7 percent in June with a further decline of 2.7 percent in July. During this same period, manufacturing employment has been only slightly positive¹¹.

Although the Japanese newspapers are filled with articles about companies cutting employment and restructuring, the aggregate data suggests that Japanese firms still provide a corporate social safety net. Although there have been lay-offs, it appears that excess labor continues to be carried by companies. Firms are employing a variety of techniques rather than firing employees: lowering bonuses, offering less part time work, and reducing the number of new hires. According to the Ministry of Labor, more than one third of young people scheduled to graduate next spring have yet to find jobs¹².

The appreciation of the yen has also added to Japan's corporate troubles and is forcing economic change.

Manufacturing firms in the export sector are being forced to reduce costs to remain competitive in world markets. Many economists argue that the appreciation of the yen is highlighting distortions in the Japanese economy with export oriented firms facing the strongest pressures to adjust and adjusting the most. Firms in protected markets or sectors which produce nontradable goods and services are not facing these same pressures and are adjusting less. Productivity gaps among different industries in Japan are increasing.

There is anecdotal evidence that these combined pressures are obliging manufacturing firms to move offshore, especially to Asia, straining inefficient keiretsu relationships and creating new import markets. The retail sector, for example, has witnessed a recent growth of discount stores and lower priced private label brands. Imports of manufactured goods rose from \$91 billion in 1988 to \$151 billion in 1994 and accounted for 55 percent of Japan's total imports in 1994 as compared with 49 percent in 1988. Perhaps more interesting is the fact that imports have continued to grow even though demand has been flat. Import volumes were up 11 percent compared to a year ago in the third quarter while exports grew only 2%¹³.

The major differences in import and domestic prices are part of the

¹¹ See, Toyo Keizai Tokei Geppo, November 1995 and JEI Report No. 30A, August 11, 1995.

¹² See, Global Data Watch, J.P.Morgan Securities Asia, Ltd. October 6, 1995.

¹³ See, Global Data Watch, J.P. Morgan Securities Asia, Ltd., October 20, 1995.

engine driving imports. As many foreign and Japanese sources amplify, there are dramatic price differentials between internal and external prices. According to a 1995 MITI White Paper, in November 1993 the cost of living in Tokyo was 41 percent higher than in New York. Durable goods were 36 percent higher, clothing 64 percent higher and food 62 percent higher¹⁴. MITI also found that prices for traded goods, raw materials, intermediate goods, and capital goods were 30 percent higher than in the United States, 19 percent higher than in Germany and 46 percent higher than in South Korea. Services were found to be 51 percent higher than in the U.S., 96 percent higher than in Germany and 475 percent higher than in Korea¹⁵. But price differences alone will not solve the problem.

A MITI survey of businesses found that Japanese firms identified excessive government regulations as the main reason for price gaps in services. This same survey found that in manufactured goods, private trade practices such as quality, service, and transactional features were the purported reasons behind the large price disparities¹⁶.

An important study by a group of Japanese economists came to a different conclusion:

the significant appreciation of the yen between 1989 and 1993, from 138 to 112 to the dollar, meant that imports were about 20 percent cheaper in yen terms in 1993 than in 1989. However, Japanese wholesale prices did not, on average, decline during this period. By implication, Japanese nontariff import barriers probably exert a greater protective effect today than they did in 1989¹⁷.

Astonishingly, MITI commented in a similar vein its 1995 White paper: "in order to reduce the domestic/external price gap we must correct the gap in productivity which is brought about by anticompetitive and inefficient regulations and trading practices"¹⁸.

¹⁴ Tsusho Hakusho, 1995 at 139.

¹⁵ *Id.* at 140.

¹⁶ *Id.* at 144.

¹⁷ See, Yoko Sazanami, Shujiro Urata, Hiroki Kawai, Measuring the Cost of Protection in Japan, Institute for International Economics. (1995) at 3.

¹⁸ Tsusho Hakusho at 146.

Japan's On-Going Debate About Deregulation

These economic factors should create a powerful domestic logic for economic deregulation. Economic deregulation would enable firms to move into more promising lines of business and would enable consumers to benefit from the price benefits of yen appreciation. Deregulation would also reduce government intervention in the economy. It offers the possibility of an improved business climate for foreign firms and new market entrants seeking to penetrate the Japanese market.

The importance of deregulation for the Japanese economy is not a new idea¹⁹. It has, however, gained renewed attention. The efforts of the Hosokawa administration and the interim and final conclusions of the Hiraiwa Commission report of late 1993 established by the Hosokawa Administration produced a burst of attention on the issue of deregulation. These reports argued that deregulation was a major means of achieving an open, vital, consumer-oriented society in harmony with the world community²⁰.

The report made plain that economic deregulation should be the rule not the exception. The interim report argued that a deregulation headquarters needed to be established in the Cabinet and headed by the Prime Minister. Further, that an impartial government organization be established by law to monitor implementation and issue recommendations to ensure that deregulation proves effective. The report attached a list of some 500 regulations and laws as examples of rules to be eliminated or revised. The report also stressed that:

fundamental revisions, while placing a burden on certain portions of the socio-economic structure in the short term, are absolutely essential in the medium and long term to construct a free socio-economic system based on the principles of self responsibility and market mechanism²¹.

¹⁹ In the early 1980s, a government commission under the chairmanship of Toshio Doko, former chairman of Keidanren, stressed the importance of deregulation as a means of reducing government expenditures and rationalizing administrative procedures. In the mid-1980s, a commission under the chairmanship of Haruo Maekawa, former Bank of Japan governor, advocated the necessity of deregulation in the context of measures to stimulate domestic demand and increase imports.

²⁰ See, A Report by the Advisory Group for Economic and Structural Reform. December 16, 1993.

²¹ See, Interim Report of the Advisory Group for Economic and Structural Reform, November 1993.

After the Hiraiwa Commission report was issued, an Administrative Reform Headquarters was established in the Prime Minister's Office. Later, in June, 1994, a package of deregulatory measures were announced. In March 1995, a five year deregulation package was finally released. (The government later decided to accelerate the timetable to three years). The March plan was comprised of some 1,091 items in 11 areas. In the process of drawing up the package, interested foreign parties submitted extensive comments. The U.S. Government and the European Union, as well as the American Chamber of Commerce in Japan and the European Business Council, have actively put forward general and specific proposals.

These developments notwithstanding, the prospects for deregulation in Japan are a mixed picture.

On the positive side of the ledger, the Japanese constituencies that have voiced support for deregulation are diverse and broad-based.

In the business community, supporters include a number of major business group such as Keidanren, Nikkeiren, and Keizai Doyukai. During and after the report of the Hiraiwa Commission, various business groups in Japan undertook a number of efforts to keep the deregulation issue alive. For example, Keidanren conducted its own studies on the gains to the economy that could come through deregulation²². Keidanren also released a paper in 1994 urging the government to adopt an approach to deregulation that incorporated principles of zero base, openness and sunset. The "zero base" principle would require evaluation of all existing regulations. Under the sunset principle, all new regulations would be reviewed within five years, and the open principle envisioned the ability of interested parties to provide input whenever legislation with a regulatory impact was debated in the Diet and would also require government officials to disclose drafts of cabinet and ministerial orders involving regulations²³.

Support is not limited to the business community. Numerous Japanese academics have written in support of specific and general deregulation proposals. The four major daily publications of Nikkei have written 7208 articles on deregulation over the last three years.

²² For example, one Keidanren report estimated that between FY 1995-2000, deregulation would result in aggregate increases in real GDP of some 177 trillion yen. Aggregate increases in jobs would amount to approximately 740,000 workers. See, Kisei Kanwa no Keizai Koka ni Kansuru Bunseki to Koyotaisaku, Keidanren. November 15, 1994.

²³ See, JEI Report 20A May 26, 1995.

A survey by Keidanren released just this month found that 94 percent of the respondents were interested in deregulation. Some 88 percent said that they would be able to accept an increase in "self responsibility" as a result of deregulation²⁴. (The latter point is important because bureaucrats often argue that the public is in favor of deregulation until it affects them adversely at which point they seek government assistance).

On the negative side of the ledger, deregulation in general and a number of specific deregulation proposals have generated a raft of detractors in Japan. Labor groups have stepped into the fray expressing concerns about the employment consequences of deregulation. An unidentified anti-deregulation group wrote an article last year in a prominent Japanese magazine (which article was entitled "A Nightmare Called Deregulation") which purportedly examined U.S. experiences with deregulation in airlines, trucking and financial services. This article, which received a lot of attention, argued that the U.S. experiences resulted in job losses, exacerbated income disparities and failed to create new industries or jobs²⁵. Those assertions were then rebutted by several prominent Japanese academic economists²⁶.

Japanese firms that see deregulation as threatening their protected niches have weighed in to thwart policy initiatives. Some ministries, notably MITI, have embraced deregulation as a concept. However, it seems that many other government ministries are resisting deregulation on many specific and general grounds. Even some consumer groups have opposed relaxation of restrictions, purportedly on health and safety grounds.

As a result of this interplay between supporters and opponents, a number of the proposals put forward by the Hiraiwa Commission were watered down. For example, bureaucrats resisted the notion of an impartial organization to monitor implementation of deregulation proposals. This was seen as treading on bureaucratic turf. Such an organization was eventually created, but it is being coordinated out of the Prime Minister's office. Even supporters of deregulation have issued stinging critiques of the "wishy washy, something-for-everyone-but-not-enough-for anyone approach" to deregulation that has come out of the government²⁷.

Domestic and international reviews of the deregulation packages to

²⁴ See, The Japan Times. October 10, 1995.

²⁵ See, Bungei Shunju, August 1994.

²⁶ See, Nakatani Iwao and Ito Takatoshi, Economist August 30, 1994.

²⁷ See, Nakatani Iwao, Economic Eye, Autumn 1994.

date have been largely critical. Some Japanese business leaders criticized the March plan as simply identifying areas for discussion rather than committing to abolish regulations²⁸.

For the time being, while deregulation remains a popular notion, the momentum behind broad-based deregulation appears to have stalled. If a pro-deregulation coalition assumes political leadership, deregulation could gain momentum. While it is far from certain what shape deregulation would take even if its staunchest supporters were to gain high office, the current state of affairs is very troubling, both from the perspective of the long-term health of the Japanese economy and from the perspective of foreign access to that important market.

Implications for Managing U.S.-Japan Relations

What does this discussion suggest for US-Japan economic and trade relations?

First on politics, it is still unclear what political "change" will come to mean in Japan. In the short run, it appears that there is more confusion in politics than change. In this environment, bureaucrats continue to steer policies in a steady but predictably cautious direction.

There are important substantive differences between individual political leaders on both foreign and domestic policy matters. Depending on who takes the helm and in what political configuration, these policy differences will matter greatly over the longer term ²⁹.

²⁸ Ambassador Mondale was widely quoted in the Japanese press as echoing this theme and saying more pointedly that Japan should adopt the principle that regulations should be exception and not the rule. Keidanren recently issued a progress report on the Governments' deregulation measures and concluded that the government has implemented some 400 or so of the pledged 1,091 measures.

²⁹ Some politicians, such as Ichiro Ozawa, have argued that Japan needs take on more responsibility for international matters. He has also made forceful arguments in favor of more political involvement in policy matters and a reduction in bureaucratic controls over the economy. Some members of his current coalition have been vocal advocates for economic deregulation. Ryutaro Hashimoto on the other hand, seems to have more respect for the bureaucracy and bureaucratic methods. Deregulation is likely not to be a front burner issue for Mr. Hashimoto.

At this instant-- and distance--the political futures of individual politicians seems to have more to do with their individual support groups, their ability to court interest groups and their political style than their position on substantive policies.

With respect to the economy, although the pace of economic change may be disappointing for many Americans and Japanese, the direction of change is promising. Market-based and other pressures are chipping away at barriers and are resulting in a relatively more open and incrementally changing Japanese economy.

Bilateral economic and trade friction will obviously continue. Friction may even intensify since the sources of friction have shifted over time from formal government barriers to a hybrid mix of government actions and the actions of private firms. The Kodak-Fuji trade dispute is a recent example.

Looking back on the recent history of bilateral trade negotiations, the U.S. and Japanese governments have engaged in numerous efforts, some contained in bilateral agreements, others pursued under more informal consultative mechanisms, to influence Japanese private business practices and thereby improve market opportunities for foreign firms----e.g., in semiconductors, paper products, glass, autos and auto parts, among others. All of these agreements contain commitments by the Government of Japan to encourage Japanese firms to use more imported items; to encourage Japanese firms to develop new business relationships with foreign firms; and to more vigorously enforce Japan's Anti-Monopoly law.

Yet there appears to be increased Japanese bureaucratic resistance to the well-heeled pattern of bilateral trade negotiations and more dissatisfaction on both sides of the Pacific with the effects of agreements reached and the process involved in reaching them. Japanese government officials appear more willing than in the past to aggressively rebut U.S. allegations about the closed nature of the Japanese market in both the Japanese and foreign media.

I think that this resistance stems from a number of factors.

First, as mentioned earlier, there has been a decline in some of the direct instruments of control over Japanese firms available to Japanese bureaucrats in an earlier period.

Second, there is increased resistance in Japan to the use of informal and non-transparent administrative guidance by government bureaucrats. U.S. government pressure on the Japanese government to remedy hybrid government-business practices is often characterized in Japan as strengthening the already heavy hand of the Japanese bureaucracy even more.

Third, in the absence of internationally agreed rules on the structural and business issues that are the sources of bilateral

friction, there appears to be more unwillingness in Japanese government circles to take up such issues bilaterally.

And fourth, a bilateral negotiating dynamic has developed in recent years between the U.S. and Japan that has failed to generate domestic supporters in Japan. Although a number of important bilateral accords have been struck, for long periods of time the only point on which U.S. and Japanese negotiators could agree was that they were engaged in sterile philosophical debates about the nature of the Japanese market. This process has unfortunately provided an additional protective shield for those bureaucratic and other interests in Japan that are reluctant to address trade or structural problems. Improving the bilateral negotiating dynamic will require adjustments in both countries.

Although "gaiatsu" or foreign pressure ---with and without the threatened use of U.S. trade laws---has been an indispensable element to securing progress on the bilateral U.S.-Japan trade agenda, and as many Japanese complain, it has been necessary to achieve changes that even some Japanese believe to be necessary, the effective exercise of gaiatsu is increasingly complex.

Over the long term, progress in achieving expanded market access can only be assured if the market opening measure have some domestic support in Japan.

In fact, such support has existed for a number of U.S. trade initiatives with Japan. For example, during the beef and citrus negotiations there were editorials in Japanese papers suggesting that concessions to the United States would benefit the interests of consumers. There were articles reminding the public that the quota system provided undue profits to those handling the quotas at the expense of the consumer. In 1983, a group of Japanese economists proposed liberalization of agricultural products including beef and citrus. In 1985, the Maekawa Report called for more opening of the agricultural market emphasizing the importance of consumer views. Even the difficult issue of rice liberalization eventually produced domestic supporters. In early 1993, more than a hundred intellectuals and experts signed an advertisement calling for acceptance of tariffication of rice³⁰.

Support within Japan for U.S. trade objectives was especially evident during the Structural Impediments Initiative (SII). This is in one sense not surprising because U.S. negotiators took great pains to try and identify issues that would benefit U.S. firms and yet were already contentious domestic issues within the Japanese political context. For example, when the U.S. identified the Large Scale Retail Store Law as an impediment to new market entrants

³⁰ These examples are drawn from an early draft of a forthcoming book by a Japanese scholar of U.S.-Japan relations.

seeking to establish larger retail chains, there were already Japanese retail chains pressing for reform. A poll by Asahi Shimbun in May 1990 showed some 58 percent of the respondents in favor of reducing regulations over large stores. Of course, not all issues in the SII generated support in Japan--keiretsu is probably the best example where there was almost no discernible support in Japan for U.S. proposals in this area. And it sometimes seemed to me that Japanese officials supported SII because the alternatives were seen as worse.

Although the results of the SII are mixed, I would argue that it was on the right track. It augmented a process of attention to structural barriers in Japan that continues to this day--be it the need for deregulation, the existence of price gaps, cartels, excessive bureaucratic discretion, more public accountability, etc. Further, at several points in the SII it was public support in Japan for U.S. negotiating objectives rather than U.S. pressure as such that obliged Japanese bureaucrats and politicians to go further than they would otherwise have chosen.

The interests of foreign companies and governments and the Japanese new to market firm and consumer are often complementary. Deregulation offers a vehicle for channeling that complementarity.

The costs to the Japanese economy of failing to continue the process of further deregulation and the domestic pressures in favor of deregulation are sufficiently great that Japanese government and private sector leaders are likely to push ahead some version of a reform process. That does not mean that the paths chosen will necessarily be those that might be desired by Japan's major trading partners. Japan is in many ways a bureaucratic society and it is likely to remain more regulated than other countries even after deregulation. There are also many cross-pressures within Japan. It is certainly possible that if there is a perceived trade-off between increased efficiency and increased unemployment on the one hand and inefficiency, lower imports and fuller employment on the other, there will be overwhelming pressures to chose the latter approach.

Deregulation is, of course, no panacea. It will not eliminate sectoral disputes between Japan and its trading partners. Focus on deregulation alone will not substitute for adequate attention to competition policy and its enforcement. Yet, foreign attention to deregulation and competition policy can play a constructive role in the debates underway in Japan.

The challenge for U.S. policymakers is to ally with those groups in Japan that are supportive of changes that are in the interests of the United States, Japan and the global economy. Further, that the U.S. pursue a trade policy approach to Japan that will more fully integrate Japan into the global economy and that is perceived by Japanese and the rest of the world as seeking that outcome.



**William R. Farrell, Ph.D.
Advanced Research Fellow
Center For International Affairs**

1995- Present

Mr. Farrell, recipient of a grant from the US-Japan Freindship Commisssion, is writing a book comparing and contrasting Japanese and American leadership styles and their impact on business practices and trade policy. He joins a select group of business, government and academic fellows conducting research into important international matters.

1990 to 1995, Executive Director, American Chamber of Commerce, Japan

Mr. Farrell directed and coordinated the activities of approximately 700 American company and 2,500 individual members of the Chamber. He was responsible for fiscal and budgetary matters of approximately \$4 million annually. An important aspect of Mr. Farrell's responsibility centered on liaison with both Japanese and American government agencies. This often involved testimony and presentations before legislative committees and government councils. Ultimately, Mr. Farrell, along with the President of the Chamber, was responsible for the presentation, explanation and defense of the American business community's interests in Japan.

1982-1990, Professor of Management, US Naval War College

Mr. Farrell was a professor for eight years at the Naval War College where he taught graduate level courses in the dynamics of decision making, policy formulation, crisis management, organizational processes, behavioral aspects of leadership and management. Student population consisted of senior military officers from the US and 34 other nations.

Mr. Farrell holds a BA in History, Fordham University (1966); a MA in East Asian Studies, Florida State University (1973); and a Ph.D. in Political Science, University of Michigan (1981). He was a career officer in the United States Air Force. During the administration of President Ronald Reagan he was a frequent consultant to the National Security Council. Mr. Farrell has published two books and contributed to five others. He regularly contributes articles and opinion pierces to Japanese and English printed media as well as provides commentary for radio and television.

William R. Farrell, Ph.D.
 Harvard University
 Center For International Affairs
 Program on US-Japan Relations
 Asia Advisory Board of Dentsu Burson-Marsteller

House Committee on International Relations
 Subcommittee on Asia and the Pacific
 Subcommittee on International Economic Policy and Trade
 October 30, 1995

If Misperceptions Were Commodities, Both Japan And The US Would Run Surpluses!

Main Points: High expectations on the part of the US that deregulation in Japan would make an important difference in the US-Japan trade balance were premature. Further, the expectation that deregulation would necessarily benefit foreign (US, European, etc.) companies was misplaced. Deregulation, like trench warfare during World War I, is a time consuming costly endeavor. Yard by yard, meter by meter, you capture what you can and move on. Further, deregulation will not mean that the Japanese government is no longer involved in business.

*The office of the Prime Minister is not powerful, especially as it relates to the President of the United States. Constitutionally and institutionally, the office, therefore, its occupant, is unable to bring about or force decision implementation. Prime Ministers perceived as "powerful" by the US owed their strength to factors other than the office they occupied. Bureaucracy is not a four-letter word. The *real* problem in Japan is *not* the bureaucracy. Rather it is a political center that is too weak to enforce its will. Bashing the bureaucracy is treating the symptom and not the illness.*

Japan watching is grand theater -- so much to observe and so much to misinterpret. The substantial mirror imaging practiced by spectators of each country often masks understanding and comprehension and instead results in confusion. Consequent heightened expectation leads, in turn, to disappointment when the other side does not behave in ways anticipated at the start.

Harvard University, Center for International Affairs, 1737 Cambridge St.,
 Room 405, Cambridge, MA 02138, Phone: 617-495-3464, Fax: 617-495-4921
 E-mail: bfarrell@cfia.harvard.edu

Americans expect that deregulation is deregulation. Yet the Japanese word, *kisei kanwa*, means an easing or relaxing of regulation, a very different concept. There is also the expectation that bureaucrats in Japan will behave much like their American counterparts, failing to appreciate that the senior levels of bureaucracy in the US frequently change with the political administration in power. This is unheard of in Japan. Further, many believe that ministries with similar names have similar roles, functions and power. For example, Japan's Ministry of Finance is not the same as the U.S. Department of Treasury in scope and authority. Likewise the Japanese Defense Agency and the American Department of Defense differ significantly.

While some Americans believe that deregulation will, "get the Japanese government out of the way" when it comes to doing business, this view is not accurate. Many senior Japanese businessmen are former 30 year bureaucratic veterans of a particular ministry, related to the industry in which they are now employed. Such long term human relations ensure close coordination between business and government.

The role and function of the Japanese Prime Minister are distinct from those of the President. Not only is the office structured differently, the extent of power and influence is inherently greater in the Office of the President than the Prime Minister. How frequently have we held high expectations for Prime Ministers, only to have them dashed? Is it Japanese behavior that should be blamed or, perhaps, US analysis of just what a Prime Minister can actually do? Do we too frequently set ourselves up for disappointment?

Former Prime Minister Morihiro Hosokawa's February 1993 visit to the United States has been portrayed as proof that Japan could finally say no to U.S. demands. Both sides of the intensive trade dispute indicated that this was the beginning of a new era: a mature relationship, where equals could agree to disagree. The stance was portrayed by many as illustrative of a new found confidence and a new found leadership on the part of the Japanese Prime Minister. But in truth, Mr. Hosokawa could not **not** say, "No." He was a more like Gulliver, tied down by so many of the Lilliputians, each with their own vested interest.

Demonstrating leadership in Japan, even at times when the current situation stridently calls for it, is no mean feat. People often describe former Prime Minister Yasuhiro Nakasone as one of Japan's strong post war leaders. Yet even he had his concerns about a prime minister's ability to influence the course of events.

"Few would deny that the prime minister's duty is to exercise leadership...Yet all through the post-World War II period, Japan's prime ministers have

Harvard University, Center for International Affairs, 1737 Cambridge St.,
Room 405, Cambridge, MA 02138, Phone: 617-495-3464, Fax: 617-495-4921
E-mail: bfarrell@cfia.harvard.edu

adhered to the role established before the war and avoided any display of the kind of leadership common in Britain and the United States. The press, being essentially antiestablishment, tends to look on a strong prime minister with suspicion and ridicule or attack him. Given this political climate and the tacit opposition of the bureaucracy, prime ministers are tempted to take the easy route and let the press and the bureaucracy run the show."

The Locus of Power

Political factionalism within the ruling parties and the bottom up style of Japanese decision-making have made the bureaucracy an exceptionally strong institution that greatly impacts the ability of individuals to exercise political leadership. At a time of significant political turmoil and transition, the ability of the bureaucracy to maintain stability -- resist any effort at change -- is very apparent. Unlike bureaucracy, instability *is* a four letter word.

As one Finance Ministry bureau chief recently commented, "We're like a society dedicated to fiscal responsibility. It's thanks to us that Japan has not ended up like the United States. Imagine what would happen if everyone in government obeyed the politicians' every whim and there was no group capable of standing up to them!"

It would be very incorrect to assume that the Ministry of Finance is like the U.S.' Department of Treasury. The Finance Ministry is far more powerful than the American counterpart. In fact, it has many of the powers and functions spread across the Treasury, Federal Reserve, Federal Deposit Insurance Corporation, Office of the Comptroller and the Securities Exchange Commission. Through the Japanese budget process, it extends its influence to and through all other ministries and agencies. The combined powers of taxation and spending are found in one organization, lead by talented, Tokyo University educated administrators.

The strength and stature of Japanese bureaucrats have been topics of many a book, article and speech. They comprise a much touted elite of well-educated, hard-working individuals, often imbued with a sense of mission, if not for the nation at least for their colleagues and institutions. It was the men of the Ministry of International Trade and Industry (MITI) and the Ministry of Finance that made Japan the economic super power it is today. It was these stalwarts who presided over the banking industry, the securities companies, the financial markets. It was these folks who helped write regulation after regulation to protect inefficient industries that are now bloated with employees and dated business practices. They saw it coming in the 1980s and have not found a solution as we pass into the mid-1990s. (Hmmm!)



Without leadership and direction, bureaucracies are more likely to focus on self preservation and institutional battles. With leadership, they can effectively work for the state. Those that take aim solely at bureaucracies may find themselves wide of the mark. What good is a hammer in the hands of a poor carpenter?

Prime ministers in Japan have small staffs, generally on loan from agencies of government. Frequently the cadre that supported one prime minister is the same for the next and the next. Their loyalties lie elsewhere and not with the incumbent. Consequently, the political leader is strongly dependent on the bureaucracies for vital information necessary for the day-to-day running of government. The prime minister's office is not structured to be powerful, no matter who sits in the chair. As one Japanese commentator advised, Hosokawa had been "trying the best he can...The pity is he doesn't have much power to carry out his pledges."

If that was the unfortunate case, placing too high an expectation on his political survival and authority, as many in Washington did, may have been a self defeating strategy. More than the problem with bureaucracy, the summer 1992-spring 1993 political coalition of eight parties was barely stable. Former Prime Minister Hosokawa was popular but not powerful. Former Prime Minister Tsutomu Hata's cameo appearance did not allow time for building power and influence. Socialist Prime Minister Tomiichi Murayama's unholy alliance with the Liberal Democratic Party and the New Party Sakigake has neutered the influence that he might normally possess.

The Murayama cabinet is so busy being worried about the preservation of political power bases that it has left an even greater amount of legislative preparation to the bureaucracy thereby, increasing its power.

Trade Drama

Main Points: The long suffering trade talks between Japan and the US are similar to a continuing unfolding drama. The pace of change in Japan is extremely slow and economic conditions drive a great deal of the change that does take place in the trade arena. The appreciation of the yen has been a major factor. The script is often set out in "zero sum" terms, failing to appreciate the economic interdependency that exists.

Watching the trade talks between Japan and the United States, the viewer might think of high drama and the art form, *kabuki*. This historical theater from Japan is highly stylized and colorful. The actors move as if every gesture has special meaning and nuance. The costuming is fantastic and the

makeup exaggerated and striking. The scenario of the trade drama might run something like this:

Outside the Japanese *kabuki-za* (theater) workers pass out pamphlets advising that the performance heralds the Japanese free traders in their battle against the forces of the U.S. manage traders. So effectively do the hawkers sound their message that few entrants doubt who are the real heroes. This would be a drama of good versus evil.

Act one had been staged in July 1993 when then stars Kiichi Miyazawa (former Prime Minister) and Bill Clinton (U.S. President) structured the framework. All the actors in the American troupe knew that they needed a new script. The old Reagan/Bush scenario had to go. After all, it was Republican and well worn. Not only that, but the U.S. acting team was new to the stage and very enthusiastic about playing their roles.

Suddenly, the Japanese actors were tossed off the stage by an irate public. The new cast, with then leading man Hosokawa, stepped in but seemed more concerned as to where to stand in relation to each other than with the content of the play itself. This group appeared to ad-lib more than follow a script. The dialogue was sometimes confusing while some actors appeared undecided.

Did they want to be part of an old traditional school or try some innovative style? When they faced the audience were the actors talking about goals, targets, criteria, measurement, commitment, promises or expectations?

All this acting is taking place while the Japanese stage managers (bureaucrats) try to deal with worn out scenery and props. Further, what the audience wants to hear may not be what it needs to hear. The spectators are concerned, for they know full well that the drama unfolding has real meaning for them. Some actors say, "Take heart, the worst is behind us." But the audience is not yet convinced and for good reason. After several years the economy was statistically getting better but the effects had not trickled down. Deregulation was proceeding at a snails pace. Market forces were driving change, not political or bureaucratic forces.

Japan is a country whose behavior is governed more by its social contracts than its politics. For now there has been some strain on the system, and change is indeed taking place, but it is part of a continuum. One historian, Carol Gluck of Columbia University calls it, "an undertow of 'unchange'." After the fall of the Tokugawa's, there was radical political reform as part of the Meiji Restoration. After World War II there again was radical reform, yet traditional societal relationships remained stable.

Harvard University, Center for International Affairs, 1737 Cambridge St.,
Room 405, Cambridge, MA 02138, Phone: 617-495-3464, Fax: 617-495-4921
E-mail: bfarrell@cfia.harvard.edu

But will this "unchange," this social stabilization force, aid Japan in meeting the requirements of the 21st Century? Repeating the moves of the traditional masters may not be enough. Economically, Peter Drucker sees the next five to ten years as a very turbulent time, the major reason being Japan's dependence on mature industries such as automobiles and consumer electronics. Additionally, he does not see the education system producing highly skilled and innovative workers required for the next century. Training an automobile factory floor worker is different from training a master of the information super highway.

Alvin Toffler, futurist and author, sees many challenges confronting Japan. "The arguments about political reform and corruption, the complex 'dance' taking place among the parties, these are all superficial events," he says. "The deeper meaning is structural." Toffler maintains that the LDP ruled for so long because it had a compact with the U.S.-- security bases in exchange for markets. With the demise of the Soviet Union and economic growth in Japan, that agreement became obsolete, causing the eventual down fall of the party. The dilemma: the restructuring that is taking place today will not be solid or stable until there is a theoretical base underneath the new government. "I don't see that yet in any of the competing parties," he concludes.

Complicating any script rewriting has been the rise of the yen. This off stage event has created enormous pressure on the actors. However, it has also provided an "excuse" to carry out the needed changes within Japan. The actors find it a lot easier to blame some force "out there" for the pain required for economic restructuring.

The expectation is that the play has many more scenes to go. Some of the leading men may be long off stage by the time of the final curtain call. This in no way diminishes their role, but attests to the complexity of this drama, with its subtle gestures and bold dialogue.

Will Western members of the audience have the patience to sit through many more acts? Is it a smart move for American companies to bypass Japan? Will Japanese companies emerge that can compete globally at ¥90 = \$1? What might the long-term implications be for US companies if that is the case?